

security or a source of payment for, an existing or planned debt obligation; or (C) Guarantee of paragraph (f)(1)(i)(A) or (B).

(ii) The term *financial obligation* shall not include municipal securities as to which a final official statement has been provided to the Municipal Securities Rulemaking Board consistent with this rule.

(g) *Transitional provision.* If on July 28, 1989, a Participating Underwriter was contractually committed to act as underwriter in an Offering of municipal securities originally issued before July 29, 1989, the requirements of paragraphs (b)(3) and (b)(4) shall not apply to the Participating Underwriter in connection with such an Offering. Paragraph (b)(5) of this section shall not apply to a Participating Underwriter that has contractually committed to act as an underwriter in an Offering of municipal securities before July 3, 1995; *except that* paragraph (b)(5)(i)(A) and paragraph (b)(5)(i)(B) shall not apply with respect to fiscal years ending prior to January 1, 1996. Paragraph (c) shall become effective on January 1, 1996. Paragraph (d)(2)(ii) and paragraph (d)(2)(iii) of this section shall not apply to an Offering of municipal securities commencing prior to January 1, 1996.

[54 FR 28813, July 10, 1989, as amended at 59 FR 59609, Nov. 17, 1994; 73 FR 76132, Dec. 15, 2008; 75 FR 33155, June 10, 2010; 83 FR 44742, Aug. 31, 2018]

§ 240.15c3-1 Net capital requirements for brokers or dealers.

(a) Every broker or dealer must at all times have and maintain net capital no less than the greater of the highest minimum requirement applicable to its ratio requirement under paragraph (a)(1) of this section, or to any of its activities under paragraph (a)(2) of this section, and must otherwise not be “insolvent” as that term is defined in paragraph (c)(16) of this section. In lieu of applying paragraphs (a)(1) and (a)(2) of this section, an OTC derivatives dealer shall maintain net capital pursuant to paragraph (a)(5) of this section. Each broker or dealer also shall comply with the supplemental requirements of paragraphs (a)(4) and (a)(9) of this section, to the extent either paragraph is applicable to its activities. In

addition, a broker or dealer shall maintain net capital of not less than its own net capital requirement plus the sum of each broker’s or dealer’s subsidiary or affiliate minimum net capital requirements, which is consolidated pursuant to appendix C, § 240.15c3-1c.

RATIO REQUIREMENTS

Aggregate Indebtedness Standard

(1)(i) No broker or dealer, other than one that elects the provisions of paragraph (a)(1)(ii) of this section, shall permit its aggregate indebtedness to all other persons to exceed 1500 percent of its net capital (or 800 percent of its net capital for 12 months after commencing business as a broker or dealer).

Alternative Standard

(ii) A broker or dealer may elect not to be subject to the Aggregate Indebtedness Standard of paragraph (a)(1)(i) of this section. That broker or dealer shall not permit its net capital to be less than the greater of \$250,000 or 2 percent of aggregate debit items computed in accordance with the Formula for Determination of Reserve Requirements for Brokers and Dealers (Exhibit A to Rule 15c3-3, § 240.15c3-3a). Such broker or dealer shall notify its Examining Authority, in writing, of its election to operate under this paragraph (a)(1)(ii). Once a broker or dealer has notified its Examining Authority, it shall continue to operate under this paragraph unless a change is approved upon application to the Commission. A broker or dealer that elects this standard and is not exempt from Rule 15c3-3 shall:

(A) Make the computation required by § 240.15c3-3(e) and set forth in Exhibit A, § 240.15c3-3a, on a weekly basis and, in lieu of the 1 percent reduction of certain debit items required by Note E (3) in the computation of its Exhibit A requirement, reduce aggregate debit items in such computation by 3 percent;

(B) Include in Items 7 and 8 of Exhibit A, § 240.15c3-3a, the market value of items specified therein more than 7 business days old;

(C) Exclude credit balances in accounts representing amounts payable for securities not yet received from the

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issuer or its agent which securities are specified in paragraphs (c)(2)(vi) (A) and (E) of this section and any related debit items from the Exhibit A requirement for 3 business days; and

(D) Deduct from net worth in computing net capital 1 percent of the contract value of all failed to deliver contracts or securities borrowed that were allocated to failed to receive contracts of the same issue and which thereby were excluded from Items 11 or 12 of Exhibit A, § 240.15c3-3a.

Futures Commission Merchants

(iii) No broker or dealer registered as a futures commission merchant shall permit its net capital to be less than the greater of its requirement under paragraph (a)(1) (i) or (ii) of this section, or 4 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the customer's account).

MINIMUM REQUIREMENTS

See Appendix E (§ 240.15c3-1E) for temporary minimum requirements.

Brokers or Dealers That Carry Customer Accounts

(2)(i) A broker or dealer (other than one described in paragraphs (a)(2)(ii) or (a)(8) of this section) shall maintain net capital of not less than \$250,000 if it carries customer or broker or dealer accounts and receives or holds funds or securities for those persons. A broker or dealer shall be deemed to receive funds, or to carry customer or broker or dealer accounts and to receive funds from those persons if, in connection with its activities as a broker or dealer, it receives checks, drafts, or other evidences of indebtedness made payable to itself or persons other than the requisite registered broker or dealer carrying the account of a customer, escrow agent, issuer, underwriter, sponsor, or other distributor of securities. A broker or dealer shall be deemed to hold securities for, or to carry customer or broker or dealer accounts, and hold securities of, those persons if

it does not promptly forward or promptly deliver all of the securities of customers or of other brokers or dealers received by the firm in connection with its activities as a broker or dealer. A broker or dealer, without complying with this paragraph (a)(2)(i), may receive securities only if its activities conform with the provisions of paragraphs (a)(2) (iv) or (v) of this section, and may receive funds only in connection with the activities described in paragraph (a)(2)(v) of this section.

(ii) A broker or dealer that is exempt from the provisions of § 240.15c3-3 pursuant to paragraph (k)(2)(i) thereof shall maintain net capital of not less than \$100,000.

Dealers

(iii) A dealer shall maintain net capital of not less than \$100,000. For the purposes of this section, the term "dealer" includes:

(A) Any broker or dealer that endorses or writes options otherwise than on a registered national securities exchange or a facility of a registered national securities association; and

(B) Any broker or dealer that effects more than ten transactions in any one calendar year for its own investment account. This section shall not apply to those persons engaging in activities described in paragraphs (a)(2)(v), (a)(2)(vi) or (a)(8) of this section, or to those persons whose underwriting activities are limited solely to acting as underwriters in best efforts or all or none underwritings in conformity with paragraph (b)(2) of § 240.15c2-4, so long as those persons engage in no other dealer activities.

Brokers or Dealers That Introduce Customer Accounts And Receive Securities

(iv) A broker or dealer shall maintain net capital of not less than \$50,000 if it introduces transactions and accounts of customers or other brokers or dealers to another registered broker or dealer that carries such accounts on a fully disclosed basis, and if the broker or dealer receives but does not hold customer or other broker or dealer securities. A broker or dealer operating under this paragraph (a)(2)(iv) of this

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section may participate in a firm commitment underwriting without being subject to the provisions of paragraph (a)(2)(iii) of this section, but may not enter into a commitment for the purchase of shares related to that underwriting.

Brokers or Dealers Engaged in the Sale of Redeemable Shares of Registered Investment Companies and Certain Other Share Accounts

(v) A broker or dealer shall maintain net capital of not less than \$25,000 if it acts as a broker or dealer with respect to the purchase, sale and redemption of redeemable shares of registered investment companies or of interests or participations in an insurance company separate account directly from or to the issuer on other than a subscription way basis. A broker or dealer operating under this section may sell securities for the account of a customer to obtain funds for the immediate reinvestment in redeemable securities of registered investment companies. A broker or dealer operating under this paragraph (a)(2)(v) must promptly transmit all funds and promptly deliver all securities received in connection with its activities as a broker or dealer, and may not otherwise hold funds or securities for, or owe money or securities to, customers.

Other Brokers or Dealers

(vi) A broker or dealer that does not receive, directly or indirectly, or hold funds or securities for, or owe funds or securities to, customers and does not carry accounts of, or for, customers and does not engage in any of the activities described in paragraphs (a)(2)(i) through (v) of this section shall maintain net capital of not less than \$5,000. A broker or dealer operating under this paragraph may engage in the following dealer activities without being subject to the requirements of paragraph (a)(2)(iii) of this section:

(A) In the case of a buy order, prior to executing such customer's order, it purchases as principal the same number of shares or purchases shares to accumulate the number of shares necessary to complete the order, which shall be cleared through another registered broker or dealer or

(B) In the case of a sell order, prior to executing such customer's order, it sells as principal the same number of shares or a portion thereof, which shall be cleared through another registered broker or dealer.

(3) [Reserved]

Capital Requirements for Market Makers

(4) A broker or dealer engaged in activities as a market maker as defined in paragraph (c)(8) of this section shall maintain net capital in an amount not less than \$2,500 for each security in which it makes a market (unless a security in which it makes a market has a market value of \$5 or less, in which event the amount of net capital shall be not less than \$1,000 for each such security) based on the average number of such markets made by such broker or dealer during the 30 days immediately preceding the computation date. Under no circumstances shall it have net capital less than that required by the provisions of paragraph (a) of this section, or be required to maintain net capital of more than \$1,000,000 unless required by paragraph (a) of this section.

(5)(i) In accordance with appendix F to this section (§240.15c3-1f), the Commission may grant an application by an OTC derivatives dealer when calculating net capital to use the market risk standards of appendix F as to some or all of its positions in lieu of the provisions of paragraph (c)(2)(vi) of this section and the credit risk standards of appendix F to its receivables (including counterparty net exposure) arising from transactions in eligible OTC derivative instruments in lieu of the requirements of paragraph (c)(2)(iv) of this section. An OTC derivatives dealer shall at all times maintain tentative net capital of not less than \$100 million and net capital of not less than \$20 million.

(ii) An OTC derivatives dealer that is also registered as a security-based swap dealer under section 15F of the Act (15 U.S.C. 78o-10) is subject to the capital requirements in §§ 240.18a-1, 240.18a-1a, 240.18a-1b, 240.18a-1c and 240.18a-1d instead of the capital requirements of this section and its appendices.

Market Makers, Specialists and Certain Other Dealers

(6)(i) A dealer who meets the conditions of paragraph (a)(6)(ii) of this section may elect to operate under this paragraph (a)(6) and thereby not apply, except to the extent required by this paragraph (a)(6), the provisions of paragraphs (c)(2)(vi) or appendix A (§240.15c3-1a) of this section to market maker and specialist transactions and, in lieu thereof, apply thereto the provisions of paragraph (a)(6)(iii) of this section.

(ii) This paragraph (a)(6) shall be available to a dealer who does not effect transactions with other than brokers or dealers, who does not carry customer accounts, who does not effect transactions in options not listed on a registered national securities exchange or facility of a registered national securities association, and whose market maker or specialist transactions are effected through and carried in a market maker or specialist account cleared by another broker or dealer as provided in paragraph (a)(6)(iv) of this section.

(iii) A dealer who elects to operate pursuant to this paragraph (a)(6) shall at all times maintain a liquidating equity in respect of securities positions in his market maker or specialist account at least equal to:

(A) An amount equal to 25 percent (5 percent in the case of exempted securities) of the market value of the long positions and 30 percent of the market value of the short positions; provided, however, in the case of long or short positions in options and long or short positions in securities other than options which relate to a bona fide hedged position as defined in paragraph (c)(2)(x)(C) of this section, such amount shall equal the deductions in respect of such positions specified by appendix A (§240.15c3-1a).

(B) Such lesser requirement as may be approved by the Commission under specified terms and conditions upon written application of the dealer and the carrying broker or dealer.

(C) For purposes of this paragraph (a)(6)(iii), equity in such specialist or market maker account shall be computed by (i) marking all securities positions long or short in the account to their respective current market values,

(2) adding (deducting in the case of a debit balance) the credit balance carried in such specialist or market maker account, and (3) adding (deducting in the case of short positions) the market value of positions long in such account.

(iv) The dealer shall obtain from the broker or dealer carrying the market maker or specialist account a written undertaking which shall be designated "Notice Pursuant to §240.15c3-1(a)(6) of Intention to Carry Specialist or Market Maker Account." Said undertaking shall contain the representations required by paragraph (a)(6) of this section and shall be filed with the Commission's Washington, DC, Office, the regional office of the Commission for the region in which the broker or dealer has its principal place of business and the Designated Examining Authorities of both firms prior to effecting any transactions in said account. The broker or dealer carrying such account:

(A) Shall mark the account to the market not less than daily and shall issue appropriate calls for additional equity which shall be met by noon of the following business day;

(B) Shall notify by telegraph the Commission and the Designated Examining Authorities pursuant to 17 CFR 240.17a-11, if the market maker or specialist fails to deposit any required equity within the time prescribed in paragraph (a)(6)(iv)(A) of this section; said telegraphic notice shall be received by the Commission and the Designated Examining Authorities not later than the close of business on the day said call is not met;

(C) Shall not extend further credit in the account if the equity in the account falls below that prescribed in paragraph (a)(6)(iii) of this section, and

(D) Shall take steps to liquidate promptly existing positions in the account in the event of a failure to meet a call for equity.

(v) No such carrying broker or dealer shall permit the sum of (A) the deductions required by paragraph (c)(2)(x)(A) of this section in respect of all transactions in market maker accounts guaranteed, indorsed or carried by such broker or dealer pursuant to paragraph (c)(2)(x) of this section and (B) the equity required by paragraph (iii) of this

paragraph (a)(6) in respect of all transactions in the accounts of specialists of market makers in options carried by such broker or dealer pursuant to this paragraph (a)(6) to exceed 1,000 percent of such broker's or dealer's net capital as defined in paragraph (c)(2) of this section for any period exceeding five business days; *Provided*, That solely for purposes of this paragraph (a)(6)(v), deductions or equity required in a specialist or market maker account in respect of positions in fully paid securities (other than options), which do not underlie options listed on the national securities exchange or facility of a national securities association of which the specialist or market maker is a member, need not be recognized. *Provided further*, That if at any time such sum exceeds 1,000 percent of such broker's or dealer's net capital, then the broker or dealer shall immediately transmit telegraphic notice of such event to the principal office of the Commission in Washington, DC, the regional office of the Commission for the region in which the broker or dealer maintains its principal place of business, and such broker's or dealer's Designated Examining Authority. *Provided further*, That if at any time such sum exceeds 1,000 percent of such broker's or dealer's net capital, then such broker or dealer shall be subject to the prohibitions against withdrawal of equity capital set forth in paragraph (e) of this section, and to the prohibitions against reduction, prepayment and repayment of subordination agreements set forth in paragraph (b)(11) of § 240.15c3-1d, as if such broker or dealer's net capital were below the minimum standards specified by each of the aforementioned paragraphs.

ALTERNATIVE NET CAPITAL COMPUTATION FOR BROKER-DEALERS AUTHORIZED TO USE MODELS

(7) In accordance with appendix E to this section (§ 240.15c3-1e), the Commission may approve, in whole or in part, an application or an amendment to an application by a broker or dealer to calculate net capital using the market risk standards of appendix E to compute a deduction for market risk on some or all of its positions, instead of the provisions of paragraphs (c)(2)(vi)

and (c)(2)(vii) of this section, and using the credit risk standards of appendix E to compute a deduction for credit risk on certain credit exposures arising from transactions in derivatives instruments, instead of the provisions of paragraph (c)(2)(iv) of this section, subject to any conditions or limitations on the broker or dealer the Commission may require as necessary or appropriate in the public interest or for the protection of investors. A broker or dealer that has been approved to calculate its net capital under appendix E must:

(i)(A) At all times maintain tentative net capital of not less than \$5 billion and net capital of not less than the greater of \$1 billion or the sum of the ratio requirement under paragraph (a)(1) of this section and:

(1) Two percent of the risk margin amount; or

(2) Four percent or less of the risk margin amount if the Commission issues an order raising the requirement to four percent or less on or after the third anniversary of this section's compliance date; or

(3) Eight percent or less of the risk margin amount if the Commission issues an order raising the requirement to eight percent or less on or after the fifth anniversary of this section's compliance date and the Commission had previously issued an order raising the requirement under paragraph (a)(7)(i)(B) of this section;

(B) If, after considering the capital and leverage levels of brokers or dealers subject to paragraph (a)(7) of this section, as well as the risks of their security-based swap positions, the Commission determines that it may be appropriate to change the percentage pursuant to paragraph (a)(7)(i)(A)(2) or (3) of this section, the Commission will publish a notice of the potential change and subsequently will issue an order regarding any such change.

(ii) Provide notice that same day in accordance with § 240.17a-11(g) if the broker's or dealer's tentative net capital is less than \$6 billion. The Commission may, upon written application, lower the threshold at which notification is necessary under this paragraph (a)(7)(ii), either unconditionally or on specified terms and conditions, if a

broker or dealer satisfies the Commission that notification at the \$6 billion threshold is unnecessary because of, among other factors, the special nature of its business, its financial position, its internal risk management system, or its compliance history; and

(iii) Comply with § 240.15c3-4 as though it were an OTC derivatives dealer with respect to all of its business activities, except that paragraphs (c)(5)(xiii), (c)(5)(xiv), (d)(8), and (d)(9) of § 240.15c3-4 shall not apply.

(8) *Municipal securities brokers' brokers.* (i) A municipal securities brokers' brokers, as defined in subsection (ii) of this paragraph (a)(8), may elect not to be subject to the limitations of paragraph (c)(2)(ix) of this section provided that such brokers' broker complies with the requirements set out in paragraphs (a)(8) (iii), (iv) and (v) of this section.

(ii) The term *municipal securities brokers' broker* shall mean a municipal securities broker or dealer who acts exclusively as an undisclosed agent in the purchase or sale of municipal securities for a registered broker or dealer or registered municipal securities dealer, who has no "customers" as defined in this rule and who does not have or maintain any municipal securities in its proprietary or other accounts.

(iii) In order to qualify to operate under this paragraph (a)(8), a brokers' broker shall at all times have and maintain net capital of not less than \$150,000.

(iv) For purposes of this paragraph (a)(8), a brokers' broker shall deduct from net worth 1% of the contract value of each municipal failed to deliver contract which is outstanding 21 business days or longer. Such deduction shall be increased by any excess of the contract price of the fail to deliver over the market value of the underlying security.

(v) For purposes of this paragraph (a)(8), a brokers' broker may exclude from its aggregate indebtedness computation indebtedness adequately collateralized by municipal securities outstanding for not more than one business day and offset by municipal securities failed to deliver of the same issue and quantity. In no event may a brokers' broker exclude any overnight

bank loan attributable to the same municipal securities failed to deliver contract for more than one business day. A brokers' broker need not deduct from net worth the amount by which the market value of securities failed to receive outstanding longer than thirty (30) calendar days exceeds the contract value of those failed to receive as required by Rule 15c3-1(c)(2)(iv)(E).

Certain Additional Capital Requirements for Brokers or Dealers Engaging in Reverse Repurchase Agreements

(9) A broker or dealer shall maintain net capital in addition to the amounts required under paragraph (a) of this section in an amount equal to 10 percent of:

(i) The excess of the market value of United States Treasury Bills, Bonds and Notes subject to reverse repurchase agreements with any one party over 105 percent of the contract prices (including accrued interest) for reverse repurchase agreements with that party;

(ii) The excess of the market value of securities issued or guaranteed as to principal or interest by an agency of the United States or mortgage related securities as defined in section 3(a)(41) of the Act subject to reverse repurchase agreements with any one party over 110 percent of the contract prices (including accrued interest) for reverse repurchase agreements with that party; and

(iii) The excess of the market value of other securities subject to reverse repurchase agreements with any one party over 120 percent of the contract prices (including accrued interest) for reverse repurchase agreements with that party.

Broker-Dealers Registered as Security-Based Swap Dealers

(10) A broker or dealer registered with the Commission as a security-based swap dealer, other than a broker or dealer subject to the provisions of paragraph (a)(7) of this section, must:

(i)(A) At all times maintain net capital of not less than the greater of \$20 million or the sum of the ratio requirement under paragraph (a)(1) of this section and:

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(1) Two percent of the risk margin amount; or

(2) Four percent or less of the risk margin amount if the Commission issues an order raising the requirement to four percent or less on or after the third anniversary of this section's compliance date; or

(3) Eight percent or less of the risk margin amount if the Commission issues an order raising the requirement to eight percent or less on or after the fifth anniversary of this section's compliance date and the Commission had previously issued an order raising the requirement under paragraph (a)(10)(i)(B) of this section;

(B) If, after considering the capital and leverage levels of brokers or dealers subject to paragraph (a)(10) of this section, as well as the risks of their security-based swap positions, the Commission determines that it may be appropriate to change the percentage pursuant to paragraph (a)(10)(i)(A)(2) or (3) of this section, the Commission will publish a notice of the potential change and subsequently will issue an order regarding any such change; and

(ii) Comply with § 240.15c3-4 as though it were an OTC derivatives dealer with respect to all of its business activities, except that paragraphs (c)(5)(xiii) and (xiv), and (d)(8) and (9) of § 240.15c3-4 shall not apply.

(b) Exemptions:

(1) The provisions of this section shall not apply to any specialist:

(i) Whose securities business, except for an occasional non-specialist related securities transaction for its own account, is limited to that of acting as an options market maker on a national securities exchange;

(ii) That is a member in good standing and subject to the capital requirements of a national securities exchange;

(iii) That does not transact a business in securities with other than a broker or dealer registered with the Commission under section 15 or section 15C of the Act or a member of a national securities exchange; and

(iv) That is not a clearing member of The Options Clearing Corporation and whose securities transactions are effected through and carried in an account cleared by another broker or

dealer registered with the Commission under section 15 of the Act.

(2) A member in good standing of a national securities exchange who acts as a floor broker (and whose activities do not require compliance with other provisions of this rule), may elect to comply, in lieu of the other provisions of this section, with the following financial responsibility standard: The value of the exchange membership of the member (based on the lesser of the most recent sale price or current bid price for an exchange membership) is not less than \$15,000, or an amount equal to the excess of \$15,000 over the value of the exchange membership is held by an independent agent in escrow: *Provided*, That the rules of such exchange require that the proceeds from the sale of the exchange membership of the member and the amount held in escrow pursuant to this paragraph shall be subject to the prior claims of the exchange and its clearing corporation and those arising directly from the closing out of contracts entered into on the floor of such exchanges.

(3) The Commission may, upon written application, exempt from the provisions of this section, either unconditionally or on specified terms and conditions, any broker or dealer who satisfies the Commission that, because of the special nature of its business, its financial position, and the safeguards it has established for the protection of customers' funds and securities, it is not necessary in the public interest or for the protection of investors to subject the particular broker or dealer to the provisions of this section.

(c) *Definitions*. For the purpose of this section:

AGGREGATE INDEBTEDNESS

(1) The term *aggregate indebtedness* shall be deemed to mean the total money liabilities of a broker or dealer arising in connection with any transaction whatsoever and includes, among other things, money borrowed, money payable against securities loaned and securities "failed to receive," the market value of securities borrowed to the extent to which no equivalent value is paid or credited (other than the market value of margin securities borrowed

from customers in accordance with the provisions of 17 CFR 240.15c3-3 and margin securities borrowed from non-customers), customers' and non-customers' free credit balances, credit balances in customers' and non-customers' accounts having short positions in securities, equities in customers' and non-customers' future commodities accounts and credit balances in customers' and non-customers' commodities accounts, but excluding:

EXCLUSIONS FROM AGGREGATE
INDEBTEDNESS

(i) Indebtedness adequately collateralized by securities which are carried long by the broker or dealer and which have not been sold or by securities which collateralize a secured demand note pursuant to appendix D to this section 17 CFR 240.15c3-1d; indebtedness adequately collateralized by spot commodities which are carried long by the broker or dealer and which have not been sold; or, until October 1, 1976, indebtedness adequately collateralized by municipal securities outstanding for not more than one business day and offset by municipal securities failed to deliver of the same issue and quantity, where such indebtedness is incurred by a broker or dealer effecting transactions solely in municipal securities who is either registered with the Commission or temporarily exempt from such registration pursuant to 17 CFR 240.15a-1(T) or 17 CFR 240.15Ba2-3(T);

(ii) Amounts payable against securities loaned, which securities are carried long by the broker or dealer and which have not been sold or which securities collateralize a secured demand note pursuant to Appendix (D) (17 CFR 240.15c)

(iii) Amounts payable against securities failed to receive which securities are carried long by the broker or dealer and which have not been sold or which securities collateralize a secured demand note pursuant to Appendix (D) (17 CFR 240.15c3-1d) or amounts payable against securities failed to receive for which the broker or dealer also has a receivable related to securities of the same issue and quantity thereof which

are either fails to deliver or securities borrowed by the broker or dealer;

(iv) Credit balances in accounts representing amounts payable for securities or money market instruments not yet received from the issuer or its agent which securities are specified in paragraph (c)(2)(vi)(E) and which amounts are outstanding in such accounts not more than three (3) business days;

(v) Equities in customers' and non-customers' accounts segregated in accordance with the provisions of the Commodity Exchange Act and the rules and regulations thereunder;

(vi) Liability reserves established and maintained for refunds of charges required by section 27(d) of the Investment Company Act of 1940, but only to the extent of amounts on deposit in a segregated trust account in accordance with 17 CFR 270.27d-1 under the Investment Company Act of 1940;

(vii) Amounts payable to the extent funds and qualified securities are required to be on deposit and are deposited in a "Special Reserve Bank Account for the Exclusive Benefit of Customers" pursuant to 17 CFR 240.15c3-3 under the Securities Exchange Act of 1934;

(viii) Fixed liabilities adequately secured by assets acquired for use in the ordinary course of the trade or business of a broker or dealer but no other fixed liabilities secured by assets of the broker or dealer shall be so excluded unless the sole recourse of the creditor for nonpayment of such liability is to such asset;

(ix) Liabilities on open contractual commitments;

(x) Indebtedness subordinated to the claims of creditors pursuant to a satisfactory subordination agreement, as defined in Appendix (D) (17 CFR 240.15c3-1d);

(xi) Liabilities which are effectively subordinated to the claims of creditors (but which are not subject to a satisfactory subordination agreement as defined in Appendix (D) (17 CFR 240.15c3-1d)) by non-customers of the broker or dealer prior to such subordination, except such subordinations by customers as may be approved by the Examining Authority for such broker or dealer;

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(xii) Credit balances in accounts of general partners;

(xiii) Deferred tax liabilities;

(xiv) Eighty-five percent of amounts payable to a registered investment company related to fail to deliver receivables of the same quantity arising out of purchases of shares of those registered investment companies; and

(xv) Eighty-five percent of amounts payable against securities loaned for which the broker or dealer has receivables related to securities of the same class and issue and quantity that are securities borrowed by the broker or dealer.

NET CAPITAL

(2) The term *net capital* shall be deemed to mean the net worth of a broker or dealer, adjusted by:

(i) *Adjustments to net worth related to unrealized profit or loss, deferred tax provisions, and certain liabilities.* (A) Adding unrealized profits (or deducting unrealized losses) in the accounts of the broker or dealer;

(B)(1) In determining net worth, all long and all short positions in listed options shall be marked to their market value and all long and all short securities and commodities positions shall be marked to their market value.

(2) In determining net worth, the value attributed to any unlisted option shall be the difference between the option's exercise value and the market value of the underlying security. In the case of an unlisted call, if the market value of the underlying security is less than the exercise value of such call it shall be given no value and in the case of an unlisted put if the market value of the underlying security is more than the exercise value of the unlisted put it shall be given no value.

(C) Adding to net worth the lesser of any deferred income tax liability related to the items in (1), (2), and (3) below, or the sum of (1), (2) and (3) below;

(1) The aggregate amount resulting from applying to the amount of the deductions computed in accordance with paragraph (c)(2)(vi) of this section and Appendices A and B, §240.15c3-1a and 240.15c3-1b, the appropriate Federal and State tax rate(s) applicable to any un-

realized gain on the asset on which the deduction was computed;

(2) Any deferred tax liability related to income accrued which is directly related to an asset otherwise deducted pursuant to this section;

(3) Any deferred tax liability related to unrealized appreciation in value of any asset(s) which has been otherwise deducted from net worth in accordance with the provisions of this section; and,

(D) Adding, in the case of future income tax benefits arising as a result of unrealized losses, the amount of such benefits not to exceed the amount of income tax liabilities accrued on the books and records of the broker or dealer, but only to the extent such benefits could have been applied to reduce accrued tax liabilities on the date of the capital computation, had the related unrealized losses been realized on that date.

(E) Adding to net worth any actual tax liability related to income accrued which is directly related to an asset otherwise deducted pursuant to this section.

(F) Subtracting from net worth any liability or expense relating to the business of the broker or dealer for which a third party has assumed the responsibility, unless the broker or dealer can demonstrate that the third party has adequate resources independent of the broker or dealer to pay the liability or expense.

(G) Subtracting from net worth any contribution of capital to the broker or dealer:

(1) Under an agreement that provides the investor with the option to withdraw the capital; or

(2) That is intended to be withdrawn within a period of one year of contribution. Any withdrawal of capital made within one year of its contribution is deemed to have been intended to be withdrawn within a period of one year, unless the withdrawal has been approved in writing by the Examining Authority for the broker or dealer.

(ii) *Subordinated liabilities.* Excluding liabilities of the broker or dealer which are subordinated to the claims of creditors pursuant to a satisfactory subordination agreement, as defined in appendix (D) (17 CFR 240.15c3-1d).

(iii) *Sole proprietors.* Deducting, in the case of a broker or dealer who is a sole proprietor, the excess of liabilities which have not been incurred in the course of business as a broker or dealer over assets not used in the business.

(iv) *Assets not readily convertible into cash.* Deducting fixed assets and assets which cannot be readily converted into cash (less any indebtedness excluded in accordance with subdivision (c)(1)(viii) of this section) including, among other things:

(A) *Fixed assets and prepaid items.* Real estate; furniture and fixtures; exchange memberships; prepaid rent, insurance and other expenses; goodwill, organization expenses;

Certain Unsecured and Partly Secured Receivables

(B) All unsecured advances and loans; deficits in customers' and non-customers' unsecured and partly secured notes; deficits in omnibus credit accounts maintained in compliance with the requirements of 12 CFR 220.7(f) of Regulation T under the Act, or similar accounts carried on behalf of another broker or dealer, after application of calls for margin, marks to the market or other required deposits that are outstanding 5 business days or less; deficits in customers' and non-customers' unsecured and partly secured accounts after application of calls for margin, marks to market or other required deposits that are outstanding 5 business days or less, except deficits in cash accounts as defined in 12 CFR 220.8 of Regulation T under the Act for which not more than one extension respecting a specified securities transaction has been requested and granted, and deducting for securities carried in any of such accounts the percentages specified in paragraph (c)(2)(vi) of this section or appendix A, § 240.15c3-1a; the market value of stock loaned in excess of the value of any collateral received therefor; receivables arising out of free shipments of securities (other than mutual fund redemptions) in excess of \$5,000 per shipment and all free shipments (other than mutual fund redemptions) outstanding more than 7 business days, and mutual fund redemptions outstanding more than 16 business days; and any collateral defi-

ciencies in secured demand notes as defined in appendix D, § 240.15c3-1d; a broker or dealer that participates in a loan of securities by one party to another party will be deemed a principal for the purpose of the deductions required under this section, unless the broker or dealer has fully disclosed the identity of each party to the other and each party has expressly agreed in writing that the obligations of the broker or dealer do not include a guarantee of performance by the other party and that such party's remedies in the event of a default by the other party do not include a right of setoff against obligations, if any, of the broker or dealer.

(C) Interest receivable, floor brokerage receivable, commissions receivable from other brokers or dealers (other than syndicate profits which shall be treated as required in paragraph (c)(2)(iv)(E) of this section), mutual fund concessions receivable and management fees receivable from registered investment companies, all of which receivables are outstanding longer than thirty (30) days from the date they arise; dividends receivable outstanding longer than thirty (30) days from the payable date; good faith deposits arising in connection with a non-municipal securities underwriting, outstanding longer than eleven (11) business days from the settlement of the underwriting with the issuer; receivables due from participation in municipal securities underwriting syndicates and municipal securities joint underwriting accounts which are outstanding longer than sixty (60) days from settlement of the underwriting with the issuer and good faith deposits arising in connection with an underwriting of municipal securities, outstanding longer than sixty (60) days from settlement of the underwriting with the issuer; and receivables due from participation in municipal securities secondary trading joint accounts, which are outstanding longer than sixty (60) days from the date all securities have been delivered by the account manager to the account members;

(D) *Insurance claims.* Insurance claims which, after seven (7) business days from the date the loss giving rise to the claim is discovered, are not covered

by an opinion of outside counsel that the claim is valid and is covered by insurance policies presently in effect; insurance claims which after twenty (20) business days from the date the loss giving rise to the claim is discovered and which are accompanied by an opinion of outside counsel described above, have not been acknowledged in writing by the insurance carrier as due and payable; and insurance claims acknowledged in writing by the carrier as due and payable outstanding longer than twenty (20) business days from the date they are so acknowledged by the carrier; and,

(E) *Other deductions.* All other unsecured receivables; all assets doubtful of collection less any reserves established therefor; the amount by which the market value of securities failed to receive outstanding longer than thirty (30) calendar days exceeds the contract value of such fails to receive; and the funds on deposit in a "segregated trust account" in accordance with 17 CFR 270.27d-1 under the Investment Company Act of 1940, but only to the extent that the amount on deposit in such segregated trust account exceeds the amount of liability reserves established and maintained for refunds of charges required by sections 27(d) and 27(f) of the Investment Company Act of 1940; *Provided*, That the following need not be deducted:

(1) Any amounts deposited in a Customer Reserve Bank Account or PAB Reserve Bank Account pursuant to § 240.15c3-3(e) or in the "special reserve account for the exclusive benefit of security-based swap customers" established pursuant to § 240.15c3-3(p)(3),

(2) Cash and securities held in a securities account at a carrying broker or dealer (except where the account has been subordinated to the claims of creditors of the carrying broker or dealer), and

(3) Clearing deposits.

(F)(1) For purposes of this paragraph:

(i) The term *reverse repurchase agreement deficit* shall mean the difference between the contract price for resale of the securities under a reverse repurchase agreement and the market value of those securities (if less than the contract price).

(ii) The term *repurchase agreement deficit* shall mean the difference between the market value of securities subject to the repurchase agreement and the contract price for repurchase of the securities (if less than the market value of the securities).

(iii) As used in paragraph (c)(2)(iv)(F)(1) of this section, the term *contract price* shall include accrued interest.

(iv) Reverse repurchase agreement deficits and the repurchase agreement deficits where the counterparty is the Federal Reserve Bank of New York shall be disregarded.

(2)(i) In the case of a reverse repurchase agreement, the deduction shall be equal to the reverse repurchase agreement deficit.

(ii) In determining the required deductions under paragraph (c)(2)(iv)(F)(2)(i) of this section, the broker or dealer may reduce the reverse repurchase agreement deficit by:

(A) Any margin or other deposits held by the broker or dealer on account of the reverse repurchase agreement;

(B) Any excess market value of the securities over the contract price for resale of those securities under any other reverse repurchase agreement with the same party;

(C) The difference between the contract price for resale and the market value of securities subject to repurchase agreements with the same party (if the market value of those securities is less than the contract price); and

(D) Calls for margin, marks to the market, or other required deposits which are outstanding one business day or less.

(3) (i) In the case of repurchase agreements, the deduction shall be:

(A) The excess of the repurchase agreement deficit over 5 percent of the contract price for resale of United States Treasury Bills, Notes and Bonds, 10 percent of the contract price for the resale of securities issued or guaranteed as to principal or interest by an agency of the United States or mortgage related securities as defined in section 3(a)(41) of the Act and 20 percent of the contract price for the resale of other securities and;

(B) The excess of the aggregate repurchase agreement deficits with any

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one party over 25 percent of the broker or dealer's net capital before the application of paragraph (c)(2)(vi) of this section (less any deduction taken with respect to repurchase agreements with that party under paragraph (c)(2)(iv)(F)(3)(i)(A) of this section) or, if greater;

(C) The excess of the aggregate repurchase agreement deficits over 300 percent of the broker's or dealer's net capital before the application of paragraph (c)(2)(vi) of this section.

(ii) In determining the required deduction under paragraph (c)(2)(iv)(F)(3)(i) of this section, the broker or dealer may reduce a repurchase agreement deficit by:

(A) Any margin or other deposits held by the broker or dealer on account of a reverse repurchase agreement with the same party to the extent not otherwise used to reduce a reverse repurchase deficit;

(B) The difference between the contract price and the market value of securities subject to other repurchase agreements with the same party (if the market value of those securities is less than the contract price) not otherwise used to reduce a reverse repurchase agreement deficit; and

(C) Calls for margin, marks to the market, or other required deposits which are outstanding one business day or less to the extent not otherwise used to reduce a reverse repurchase agreement deficit.

(G) *Securities borrowed.* 1 percent of the market value of securities borrowed collateralized by an irrevocable letter of credit.

(H) Any receivable from an affiliate of the broker or dealer (not otherwise deducted from net worth) and the market value of any collateral given to an affiliate (not otherwise deducted from net worth) to secure a liability over the amount of the liability of the broker or dealer unless the books and records of the affiliate are made available for examination when requested by the representatives of the Commission or the Examining Authority for the broker or dealer in order to demonstrate the validity of the receivable or payable. The provisions of this subsection shall not apply where the affiliate is a registered broker or dealer,

registered government securities broker or dealer or bank as defined in section 3(a)(6) of the Act or insurance company as defined in section 3(a)(19) of the Act or investment company registered under the Investment Company Act of 1940 or federally insured savings and loan association or futures commission merchant registered pursuant to the Commodity Exchange Act.

(v)(A) Deducting the market value of all short securities differences (which shall include securities positions reflected on the securities record which are not susceptible to either count or confirmation) unresolved after discovery in accordance with the following schedule:

| Differences ¹ | Numbers of business days after discovery |
|--------------------------|--|
| 25 percent | 7 |
| 50 percent | 14 |
| 75 percent | 21 |
| 100 percent | 28 |

¹ Percentage of market value of short securities differences.

(B) Deducting the market value of any long securities differences, where such securities have been sold by the broker or dealer before they are adequately resolved, less any reserves established therefor;

(C) The designated examining authority for a broker or dealer may extend the periods in (v)(A) of this section for up to 10 business days if it finds that exceptional circumstances warrant an extension.

Securities Haircuts

(vi) Deducting the percentages specified in paragraphs (c)(2)(vi) (A) through (M) of this section (or the deductions prescribed for securities positions set forth in Appendix A (§240.15c3-1a) of the market value of all securities, money market instruments or options in the proprietary or other accounts of the broker or dealer.

(A)(I) In the case of a security issued or guaranteed as to principal or interest by the United States or any agency thereof, the applicable percentages of the market value of the net long or short position in each of the categories specified below are:

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CATEGORY 1

- (i) Less than 3 months to maturity—0 percent.
- (ii) 3 months but less than 6 months to maturity— $\frac{1}{2}$ of 1 percent.
- (iii) 6 months but less than 9 months to maturity— $\frac{3}{4}$ of 1 percent.
- (iv) 9 months but less than 12 months to maturity—1 percent.

CATEGORY 2

- (i) 1 year but less than 2 years to maturity— $\frac{1}{2}$ percent.
- (ii) 2 years but less than 3 years to maturity—2 percent.

CATEGORY 3

- (i) 3 years but less than 5 years to maturity—3%.
- (ii) 5 years but less than 10 years to maturity—4%.

CATEGORY 4

- (i) 10 years but less than 15 years to maturity— $4\frac{1}{2}$ %.
- (ii) 15 years but less than 20 years to maturity—5%.
- (iii) 20 years but less than 25 years to maturity— $5\frac{1}{2}$ %.
- (iv) 25 years or more to maturity—6%.

Brokers or dealers shall compute a deduction for each category above as follows: Compute the deductions for the net long or short positions in each subcategory above. The deduction for the category shall be the net of the aggregate deductions on the long positions and the aggregate deductions on the short positions in each category plus 50% of the lesser of the aggregate deductions on the long or short positions.

(2) A broker or dealer may elect to deduct, in lieu of the computation required under paragraph (c)(2)(vi)(A)(I) of this section, the applicable percentages of the market value of the net long or short positions in each of the subcategories specified in paragraph (c)(2)(vi)(A)(I) of this section.

(3) In computing deductions under paragraph (c)(2)(vi)(A)(I) of this section, a broker or dealer may elect to exclude the market value of a long or short security from one category and a security from another category, *Provided, That:*

(i) Such securities have maturity dates:

(A) Between 9 months and 15 months and within 3 months of one another.

(B) Between 2 years and 4 years and within 1 year of one another; or

(C) Between 8 years and 12 years and within 2 years of one another.

(ii) The net market value of the two excluded securities shall remain in the category of the security with the higher market value.

(4) In computing deductions under paragraph (c)(2)(vi)(A)(I) of this section, a broker or dealer may include in the categories specified in paragraph (c)(2)(vi)(A)(I) of this section, long or short positions in securities issued by the United States or any agency thereof that are deliverable against long or short positions in futures contracts relating to Government securities, traded on a recognized contract market approved by the Commodity Futures Trading Commission, which are held in the proprietary or other accounts of the broker or dealer. The value of the long or short positions included in the categories shall be determined by the contract value of the futures contract held in the account. The provisions of Appendix B to Rule 15c3-1 (17 CFR 240.15c3-1b) will in any event apply to the positions in futures contracts.

(5) In the case of a Government securities dealer that reports to the Federal Reserve System, that transacts business directly with the Federal Reserve System, and that maintains at all times a minimum net capital of at least \$50,000,000, before application of the deductions provided for in paragraph (c)(2)(vi) of this section, the deduction for a security issued or guaranteed as to principal or interest by the United States or any agency thereof shall be 75 percent of the deduction otherwise computed under paragraph (c)(2)(vi)(A) of this section.

(B)(I) In the case of any municipal security which has a scheduled maturity at date of issue of 731 days or less and which is issued at par value and pays interest at maturity, or which is issued at a discount, and which is not traded flat or in default as to principal or interest, the applicable percentages of the market value on the greater of the long or short position in each of the categories specified below are:

(i) Less than 30 days to maturity—0%.

(ii) 30 days but less than 91 days to maturity— $\frac{1}{8}$ of 1%.

(iii) 91 days but less than 181 days to maturity— $\frac{1}{4}$ of 1%.

(iv) 181 days but less than 271 days to maturity— $\frac{3}{8}$ of 1%.

(v) 271 days but less than 366 days to maturity— $\frac{1}{2}$ of 1%.

(vi) 366 days but less than 456 days to maturity— $\frac{3}{4}$ of 1%.

(vii) 456 days but less than 732 days to maturity—1%.

(2) In the case of any municipal security, other than those specified in paragraph (c)(2)(vi)(B)(I), which is not traded flat or in default as to principal or interest, the applicable percentages of the market value of the greater of the long or short position in each of the categories specified below are:

(i) Less than 1 year to maturity—1%.

(ii) 1 year but less than 2 years to maturity—2%.

(iii) 2 years but less than 3½ years to maturity—3%.

(iv) 3½ years but less than 5 years to maturity—4%.

(v) 5 years but less than 7 years to maturity—5%.

(vi) 7 years but less than 10 years to maturity—5½%.

(vii) 10 years but less than 15 years to maturity—6%.

(viii) 15 years but less than 20 years to maturity—6½%.

(ix) 20 years or more to maturity—7%.

(C) *Canadian Debt Obligations.* In the case of any security issued or unconditionally guaranteed as to principal and interest by the Government of Canada, the percentages of market value to be deducted shall be the same as in paragraph (A) of this section.

(D)(I) In the case of redeemable securities of an investment company registered under the Investment Company Act of 1940, which assets consist of cash or money market instruments and which is described in §270.2a-7 of this chapter, the deduction will be 2% of the market value of the greater of the long or short position.

(2) In the case of redeemable securities of an investment company registered under the Investment Company Act of 1940, which assets are in the form of cash or securities or money market instruments of any maturity

which are described in paragraph (c)(2)(vi) (A) through (C) or (E) of this section, the deduction shall be 7% of the market value of the greater of the long or short positions.

(3) In the case of redeemable securities of an investment company registered under the Investment Company Act of 1940, which assets are in the form of cash or securities or money market instruments which are described in paragraphs (c)(2)(vi) (A) through (C) or (E) and (F) of this section, the deduction shall be 9% of the market value of the long or short position.

(E) *Commercial paper, bankers' acceptances and certificates of deposit.* In the case of any short term promissory note or evidence of indebtedness which has a fixed rate of interest or is sold at a discount, which has a maturity date at date of issuance not exceeding nine months exclusive of days of grace, or any renewal thereof, the maturity of which is likewise limited and has only a minimal amount of credit risk, or in the case of any negotiable certificates of deposit or bankers' acceptance or similar type of instrument issued or guaranteed by any bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(6)), the applicable percentage of the market value of the greater of the long or short position in each of the categories specified below are:

(1) Less than 30 days to maturity—0 percent.

(2) 30 days but less than 91 days to maturity— $\frac{1}{8}$ of 1 percent.

(3) 91 days but less than 181 days to maturity— $\frac{1}{4}$ of 1 percent.

(4) 181 days but less than 271 days to maturity— $\frac{3}{8}$ of 1 percent.

(5) 271 days but less than 1 year to maturity— $\frac{1}{2}$ of 1 percent; and

(6) With respect to any negotiable certificate of deposit or bankers acceptance or similar type of instrument issued or guaranteed by any bank, as defined above, having 1 year or more to maturity, the deduction shall be on the greater of the long or short position and shall be the same percentage as that prescribed in paragraph (c)(2)(vi)(A) of this section.

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(F)(1) *Nonconvertible debt securities.* In the case of nonconvertible debt securities having a fixed interest rate and a fixed maturity date, which are not traded flat or in default as to principal or interest and which have only a minimal amount of credit risk, the applicable percentages of the market value of the greater of the long or short position in each of the categories specified below are:

- (i) Less than 1 year to maturity—2%
- (ii) 1 year but less than 2 years to maturity—3%
- (iii) 2 years but less than 3 years to maturity—5%
- (iv) 3 years but less than 5 years to maturity—6%
- (v) 5 years but less than 10 years to maturity—7%
- (vi) 10 years but less than 15 years to maturity—7½%
- (vii) 15 years but less than 20 years to maturity—8%
- (viii) 20 years but less than 25 years to maturity—8½%
- (ix) 25 years or more to maturity—9%

(2) A broker or dealer may elect to exclude from the above categories long or short positions that are hedged with short or long positions in securities issued by the United States or any agency thereof or nonconvertible debt securities having a fixed interest rate and a fixed maturity date and which are not traded flat or in default as to principal or interest, and which have only a minimal amount of credit risk if such securities have maturity dates:

- (i) Less than five years and within 6 months of each other;
- (ii) Between 5 years and 10 years and within 9 months of each other;
- (iii) Between 10 years and 15 years and within 2 years of each other; or
- (iv) 15 years or more and within 10 years of each other.

The broker-dealer shall deduct the amounts specified in paragraphs (c)(2)(vi)(F)(3) and (4) of this section.

(3) With respect to those positions described in paragraph (c)(2)(vi)(F)(2) of this section that include a long or short position in securities issued by the United States or any agency thereof, the broker or dealer shall exclude the hedging short or long United States or agency securities position from the applicable haircut category

under paragraph (c)(2)(vi)(A) of this section. The broker or dealer shall deduct the percentage of the market value of the hedged long or short position in nonconvertible debt securities as specified in each of the categories below:

- (i) Less than 5 years to maturity—1½%
- (ii) 5 years but less than 10 years to maturity—2½%
- (iii) 10 years but less than 15 years to maturity—2¾%
- (iv) 15 years or more to maturity—3%

(4) With respect to those positions described in paragraph (c)(2)(vi)(F)(2) of this section that include offsetting long and short positions in nonconvertible debt securities, the broker or dealer shall deduct a percentage of the market value of the hedged long or short position in nonconvertible debt securities as specified in each of the categories below:

- (i) Less than 5 years to maturity—1¾%
- (ii) 5 years but less than 10 years to maturity—3%
- (iii) 10 years but less than 15 years to maturity—3¼%
- (iv) 15 years or more to maturity—3½%

(5) In computing deductions under paragraph (c)(2)(vi)(F)(3) of this section, a broker or dealer may include in the categories specified in paragraph (c)(2)(vi)(F)(3) of this section, long or short positions in securities issued by the United States or any agency thereof that are deliverable against long or short positions in futures contracts relating to Government securities, traded on a recognized contract market approved by the Commodity Futures Trading Commission, which are held in the proprietary or other accounts of the broker or dealer. The value of the long or short positions included in the categories shall be determined by the contract value of the futures contract held in the account.

(6) The provisions of Appendix B to Rule 15c3-1 (17 CFR 240.15c3-1b) will in any event apply to the positions in futures contracts.

(G) *Convertible debt securities.* In the case of a debt security not in default which has a fixed rate of interest and a

fixed maturity date and which is convertible into an equity security, the deductions shall be as follows: If the market value is 100 percent or more of the principal amount, the deduction shall be determined as specified in paragraph (c)(2)(vi)(J) of this section; if the market value is less than the principal amount, the deduction shall be determined as specified in paragraph (F) of this section; if such securities are rated as required of paragraph (F) of this section;

(H) In the case of cumulative, non-convertible preferred stock ranking prior to all other classes of stock of the same issuer, which has only a minimal amount of credit risk and which are not in arrears as to dividends, the deduction shall be 10% of the market value of the greater of the long or short position.

(I) In order to apply a deduction under paragraphs (c)(2)(vi)(E), (c)(2)(vi)(F)(1), (c)(2)(vi)(F)(2), or (c)(2)(vi)(H) of this section, the broker or dealer must assess the creditworthiness of the security or money market instrument pursuant to policies and procedures for assessing and monitoring creditworthiness that the broker or dealer establishes, documents, maintains, and enforces. The policies and procedures must be reasonably designed for the purpose of determining whether a security or money market instrument has only a minimal amount of credit risk. Policies and procedures that are reasonably designed for this purpose should result in assessments of creditworthiness that typically are consistent with market data. A broker-dealer that opts not to make an assessment of creditworthiness under this paragraph may not apply the deductions under paragraphs (c)(2)(vi)(E), (c)(2)(vi)(F)(1), (c)(2)(vi)(F)(2), or (c)(2)(vi)(H) of this section.

NOTE TO PARAGRAPH (c)(2)(vi)(I): For a discussion of the “minimal amount of credit risk” standard, see *Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934*, Exchange Act Release No. 34-71194 (Dec. 27, 2013), at <http://www.sec.gov/rules/final.shtml>.

All Other Securities

(J) In the case of all securities or evidences of indebtedness, except those

described in appendix A, § 240.15c3-1a, which are not included in any of the percentage categories enumerated in paragraphs (c)(2)(vi) (A) through (H) of this section or paragraph (c)(2)(vi)(K)(ii) of this section, the deduction shall be 15 percent of the market value of the greater of the long or short positions and to the extent the market value of the lesser of the long or short positions exceeds 25 percent of the market value of the greater of the long or short positions, the percentage deduction on such excess shall be 15 percent of the market value of such excess. No deduction need be made in the case of:

(1) A security that is convertible into or exchangeable for another security within a period of 90 days, subject to no conditions other than the payment of money, and the other securities into which such security is convertible or for which it is exchangeable, are short in the accounts of such broker or dealer; or

(2) A security that has been called for redemption and that is redeemable within 90 days.

(K) *Securities with a limited market.* In the case of securities (other than exempted securities, nonconvertible debt securities, and cumulative nonconvertible preferred stock) which are not: (1) Traded on a national securities exchange; (2) designated as “OTC Margin Stock” pursuant to Regulation T under the Securities Exchange Act of 1934; (3) quoted on “NASDAQ”; or (4) redeemable shares of investment companies registered under the Investment Company Act of 1940, the deduction shall be as follows:

(i) In the case where there are regular quotations in an inter-dealer quotations system for the securities by three or more independent market-makers (exclusive of the computing broker or dealer) and where each such quotation represents a bona fide offer to brokers or dealers to both buy and sell in reasonable quantities at stated prices, or where a ready market as defined in paragraph (c)(11) (ii) is deemed to exist, the deduction shall be determined in accordance with paragraph (c)(2)(vi)(J) of this section;

(ii) In the case where there are regular quotations in an inter-dealer

quotations system for the securities by only one or two independent market-makers (exclusive of the computing broker or dealer) and where each such quotation represents a bona fide offer to brokers or dealers both to buy and sell in reasonable quantities, at stated prices, the deduction on both the long and short position shall be 40 percent.

(L) Where a broker or dealer demonstrates that there is sufficient liquidity for any securities long or short in the proprietary or other accounts of the broker or dealer which are subject to a deduction required by paragraph (c)(2)(vi)(K) of this section, such deduction, upon a proper showing to the Examining Authority for the broker or dealer, may be appropriately decreased, but in no case shall such deduction be less than that prescribed in paragraph (c)(2)(vi)(J) of this section.

Undue Concentration

(M)(1) In the case of money market instruments, or securities of a single class or series of an issuer, including any option written, endorsed or held to purchase or sell securities of such a single class or series of an issuer (other than "exempted securities" and redeemable securities of an investment company registered pursuant to the Investment Company Act of 1940), and securities underwritten (in which case the deduction provided for herein shall be applied after 11 business days), which are long or short in the proprietary or other accounts of a broker or dealer, including securities that are collateral to secured demand notes defined in appendix D, § 240.15c3-1d, and that have a market value of more than 10 percent of the "net capital" of a broker or dealer before the application of paragraph (c)(2)(vi) of this section or appendix A, § 240.15c3-1a, there shall be an additional deduction from net worth and/or the Collateral Value for securities collateralizing a secured demand note defined in appendix D, § 240.15c3-1d, equal to 50 percent of the percentage deduction otherwise provided by this paragraph (c)(2)(vi) of this section or appendix A, § 240.15c3-1a, on that portion of the securities position in excess of 10 percent of the "net capital" of the broker or dealer before the application of paragraph (c)(2)(vi) of this

section and appendix A, § 240.15c3-1a. In the case of securities described in paragraph (c)(2)(vi)(J), the additional deduction required by this paragraph (c)(2)(vi)(M) shall be 15 percent.

(2) This paragraph (c)(2)(vi)(M) shall apply notwithstanding any long or short position exemption provided for in paragraph (c)(2)(vi)(J) of this section (except for long or short position exemptions arising out of the first proviso to paragraph (c)(2)(vi)(J)) and the deduction on any such exempted position shall be 15 percent of that portion of the securities position in excess of 10 percent of the broker or dealer's net capital before the application of paragraph (c)(2)(vi) of this section and appendix A, § 240.15c3-1a.

(3) This paragraph (c)(2)(vi)(M) shall be applied to an issue of equity securities only on the market value of such securities in excess of \$10,000 or the market value of 500 shares, whichever is greater, or \$25,000 in the case of a debt security.

(4) This paragraph (c)(2)(vi)(M) will be applied to an issue of municipal securities having the same security provisions, date of issue, interest rate, day, month and year of maturity only if such securities have a market value in excess of \$500,000 in bonds (\$5,000,000 in notes) or 10 percent of tentative net capital, whichever is greater, and are held in position longer than 20 business days from the date the securities are received by the syndicate manager from the issuer.

(5) Any specialist that is subject to a deduction required by this paragraph (c)(2)(vi)(M), respecting its specialty stock, that can demonstrate to the satisfaction of the Examining Authority for such broker or dealer that there is sufficient liquidity for such specialist's specialty stock and that such deduction need not be applied in the public interest for the protection of investors, may upon a proper showing to such Examining Authority have such undue concentration deduction appropriately decreased, but in no case shall the deduction prescribed in paragraph (c)(2)(vi)(J) of this section above be reduced. Each such Examining Authority shall make and preserve for a period of not less than 3 years a record of each application granted pursuant to this

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paragraph (c)(2)(vi)(M)(5), which shall contain a summary of the justification for the granting of the application.

(N) Any specialist that limits its securities business to that of a specialist (except for an occasional non-specialist related securities transaction for its own account), that does not transact a business in securities with other than a broker or dealer registered with the Commission under section 15 or 15C of the Act or a member of a national securities exchange, and that is not a clearing member of The Options Clearing Corporation need not deduct from net worth in computing net capital those deductions, as to its specialty securities, set forth in paragraph (c)(2)(vi) of this section or appendix A to this section, except for paragraph (e) of this section limiting withdrawals of equity capital and appendix D to this section relating to satisfactory subordination agreements. As to a specialist that is solely an options specialist, in paragraph (e) the term “net capital” shall be deemed to mean “net capital before the application of paragraph (c)(2)(vi) of this section or appendix A to this section” and “excess net capital” shall be deemed to be the amount of net capital before the application of paragraph (c)(2)(vi) of this section or

appendix A to this section in excess of the amount of net capital required under paragraph (a) of this section. In reports filed pursuant to § 240.17a-5 and in making the record required by § 240.17a-3(a)(11) each specialists shall include the deductions that would otherwise have been required by paragraph (c)(2)(vi) of this section or appendix A to this section in the absence of this paragraph (c)(2)(vi)(N).

(O) *Cleared security-based swaps.* In the case of a cleared security-based swap held in a proprietary account of the broker or dealer, deducting the amount of the applicable margin requirement of the clearing agency or, if the security-based swap references an equity security, the broker or dealer may take a deduction using the method specified in § 240.15c3-1a.

(P) *Non-cleared security-based swaps—(1) Credit default swaps—(i) Short positions (selling protection).* In the case of a non-cleared security-based swap that is a short credit default swap, deducting the percentage of the notional amount based upon the current basis point spread of the credit default swap and the maturity of the credit default swap in accordance with table 1 to § 240.15c3-1(c)(2)(vi)(P)(1)(i):

TABLE 1 TO § 240.15c3-1(c)(2)(vi)(P)(1)(i)

| Length of time to maturity of credit default swap contract | Basis point spread | | | | | |
|--|--------------------|-----------|-----------|-----------|-----------|---------------|
| | 100 or less % | 101-300 % | 301-400 % | 401-500 % | 501-699 % | 700 or more % |
| Less than 12 months | 1.00 | 2.00 | 5.00 | 7.50 | 10.00 | 15.00 |
| 12 months but less than 24 months | 1.50 | 3.50 | 7.50 | 10.00 | 12.50 | 17.50 |
| 24 months but less than 36 months | 2.00 | 5.00 | 10.00 | 12.50 | 15.00 | 20.00 |
| 36 months but less than 48 months | 3.00 | 6.00 | 12.50 | 15.00 | 17.50 | 22.50 |
| 48 months but less than 60 months | 4.00 | 7.00 | 15.00 | 17.50 | 20.00 | 25.00 |
| 60 months but less than 72 months | 5.50 | 8.50 | 17.50 | 20.00 | 22.50 | 27.50 |
| 72 months but less than 84 months | 7.00 | 10.00 | 20.00 | 22.50 | 25.00 | 30.00 |
| 84 months but less than 120 months | 8.50 | 15.00 | 22.50 | 25.00 | 27.50 | 40.00 |
| 120 months and longer | 10.00 | 20.00 | 25.00 | 27.50 | 30.00 | 50.00 |

(ii) *Long positions (purchasing protection).* In the case of a non-cleared security-based swap that is a long credit default swap, deducting 50 percent of the deduction that would be required by paragraph (c)(2)(vi)(P)(1)(i) of this section if the non-cleared security-based swap was a short credit default swap, each such deduction not to exceed the current market value of the long position.

(iii) *Long and short credit default swaps.* In the case of non-cleared security-based swaps that are long and short credit default swaps referencing the same entity (in the case of non-cleared credit default swap security-based swaps referencing a corporate entity) or obligation (in the case of non-cleared credit default swap security-based swaps referencing an asset-backed security), that have the same

credit events which would trigger payment by the seller of protection, that have the same basket of obligations which would determine the amount of payment by the seller of protection upon the occurrence of a credit event, that are in the same or adjacent spread category, and that are in the same or adjacent maturity category and have a maturity date within three months of the other maturity category, deducting the percentage of the notional amount specified in the higher maturity category under paragraph (c)(2)(vi)(P)(I)(i) or (ii) on the excess of the long or short position. In the case of non-cleared security-based swaps that are long and short credit default swaps referencing corporate entities in the same industry sector and the same spread and maturity categories prescribed in paragraph (c)(2)(vi)(P)(I)(i) of this section, deducting 50 percent of the amount required by paragraph (c)(2)(vi)(P)(I)(i) of this section on the short position plus the deduction required by paragraph (c)(2)(vi)(P)(I)(ii) of this section on the excess long position, if any. For the purposes of this section, the broker or dealer must use an industry sector classification system that is reasonable in terms of grouping types of companies with similar business activities and risk characteristics and the broker or dealer must document the industry sector classification system used pursuant to this section.

(iv) *Long security and long credit default swap.* In the case of a non-cleared security-based swap that is a long credit default swap referencing a debt security and the broker or dealer is long the same debt security, deducting 50 percent of the amount specified in paragraph (c)(2)(vi) or (vii) of this section for the debt security, provided that the broker or dealer can deliver the debt security to satisfy the obligation of the broker or dealer on the credit default swap.

(v) *Short security and short credit default swap.* In the case of a non-cleared security-based swap that is a short credit default swap referencing a debt security or a corporate entity, and the broker or dealer is short the debt security or a debt security issued by the corporate entity, deducting the amount specified in paragraph (c)(2)(vi)

or (vii) of this section for the debt security. In the case of a non-cleared security-based swap that is a short credit default swap referencing an asset-backed security and the broker or dealer is short the asset-backed security, deducting the amount specified in paragraph (c)(2)(vi) or (vii) of this section for the asset-backed security.

(2) *Non-cleared security-based swaps that are not credit default swaps.* In the case of a non-cleared security-based swap that is not a credit default swap, deducting the amount calculated by multiplying the notional amount of the security-based swap and the percentage specified in paragraph (c)(2)(vi) of this section applicable to the reference security. A broker or dealer may reduce the deduction under this paragraph (c)(2)(vi)(P)(2) by an amount equal to any reduction recognized for a comparable long or short position in the reference security under paragraph (c)(2)(vi) of this section and, in the case of a security-based swap referencing an equity security, the method specified in § 240.15c3-1a.

(vii) *Non-marketable securities.* Deducting 100 percent of the carrying value in the case of securities or evidence of indebtedness in the proprietary or other accounts of the broker or dealer, for which there is no ready market, as defined in paragraph (c)(11) of this section, and securities, in the proprietary or other accounts of the broker or dealer, which cannot be publicly offered or sold because of statutory, regulatory or contractual arrangements or other restrictions.

Open Contractual Commitments

(viii) Deducting, in the case of a broker or dealer that has open contractual commitments (other than those option positions subject to appendix A, § 240.15c3-1a), the respective deductions as specified in paragraph (c)(2)(vi) of this section or appendix B, § 240.15c3-1b, from the value (which shall be the market value whenever there is a market) of each net long and each net short position contemplated by any open contractual commitment in the proprietary or other accounts of the broker or dealer.

(A) The deduction for contractual commitments in those securities that

are treated in paragraph (c)(2)(vi)(J) of this section shall be 30 percent unless the class and issue of the securities subject to the open contractual commitment deduction are listed for trading on a national securities exchange or are designated as NASDAQ National Market System Securities.

(B) A broker or dealer that maintains in excess of \$250,000 of net capital may add back to net worth up to \$150,000 of any deduction computed under this paragraph (c)(2)(viii)(B).

(C) The deduction with respect to any single commitment shall be reduced by the unrealized profit in such commitment, in an amount not greater than the deduction provided for by this paragraph (or increased by the unrealized loss), in such commitment, and in no event shall an unrealized profit on any closed transactions operate to increase net capital.

(ix) Deducting from the contract value of each failed to deliver contract that is outstanding five business days or longer (21 business days or longer in the case of municipal securities) the percentages of the market value of the underlying security that would be required by application of the deduction required by paragraph (c)(2)(vi) of this section. Such deduction, however, shall be increased by any excess of the contract price of the failed to deliver contract over the market value of the underlying security or reduced by any excess of the market value of the underlying security over the contract value of the failed to deliver contract, but not to exceed the amount of such deduction. The designated examining authority for the broker or dealer may, upon application of the broker or dealer, extend for a period up to 5 business days, any period herein specified when it is satisfied that the extension is warranted. The designated examining authority upon expiration of the extension may extend for one additional period of up to 5 business days, any period herein specified when it is satisfied that the extension is warranted.

Brokers or Dealers Carrying Accounts of Listed Options Specialists

(x)(A) With respect to any transaction of a specialist in listed options, who is either not otherwise subject to

the provisions of this section or is described in paragraph (c)(2)(vi)(N) of this section, for whose specialist account a broker or dealer acts as a guarantor, endorser, or carrying broker or dealer, such broker or dealer shall adjust its net worth by deducting as of noon of each business day the amounts computed as of the prior business day pursuant to § 240.15c3-1a. The required deductions may be reduced by any liquidating equity that exists in such specialist's market-maker account as of that time and shall be increased to the extent of any liquidating deficit in such account. Noon shall be determined according to the local time where the broker or dealer is headquartered. In no event shall excess equity in the specialist's market-maker account result in an increase of the net capital of any such guarantor, endorser, or carrying broker or dealer.

(B) *Definitions.* (1) The term *listed option* shall mean any option traded on a registered national securities exchange or automated facility of a registered national securities association.

(2) For purposes of this section, the equity in an individual specialist's market-maker account shall be computed by:

(i) Marking all securities positions long or short in the account to their respective current market values;

(ii) Adding (deducting in the case of a debit balance) the credit balance carried in such specialist's market-maker account; and

(iii) Adding (deducting in the case of short positions) the market value of positions long in such account.

(C) No guarantor, endorser, or carrying broker or dealer shall permit the sum of the deductions required pursuant to § 240.15c3-1a in respect of all transactions in specialists' market-maker accounts guaranteed, endorsed, or carried by such broker or dealer to exceed 1,000 percent of such broker's or dealer's net capital as defined in § 240.15c3-1(c)(2) for any period exceeding three business days. If at any time such sum exceeds 1,000 percent of such broker's or dealer's net capital, then the broker or dealer shall:

(1) Immediately transmit telegraphic or facsimile notice of such event to the Division of Market Regulation in the

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headquarters office of the Commission in Washington, DC, to the regional office of the Commission for the region in which the broker or dealer maintains its principal place of business, and to its examining authority designated pursuant to section 17(d) of the Act (15 U.S.C. 78q(d)) (“Designated Examining Authority”); and

(2) Be subject to the prohibitions against withdrawal of equity capital set forth in §240.15c3-1(e) and to the prohibitions against reduction, prepayment, and repayment of subordination agreements set forth in paragraph (b)(11) of §240.15c3-1d, as if such broker or dealer’s net capital were below the minimum standards specified by each of those paragraphs.

(D) If at any time there is a liquidating deficit in a specialist’s market-maker account, then the broker or dealer guaranteeing, endorsing, or carrying listed options transactions in such specialist’s market-maker account may not extend any further credit in that account, and shall take steps to liquidate promptly existing positions in the account. This paragraph shall not prevent the broker or dealer from, upon approval by the broker’s or dealer’s Designated Examining Authority, entering into hedging positions in the specialist’s market-maker account. The broker or dealer also shall transmit telegraphic or facsimile notice of the deficit and its amount by the close of business of the following business day to its Designated Examining Authority and the Designated Examining Authority of the specialist, if different from its own.

(E) Upon written application to the Commission by the specialist and the broker or dealer guaranteeing, endorsing, or carrying options transactions in such specialist’s market-maker account, the Commission may approve upon specified terms and conditions lesser adjustments to net worth than those specified in §240.15c3-1a.

(xi) *Brokers or dealers carrying specialists or market makers accounts.* With respect to a broker or dealer who carries a market maker or specialist account, or with respect to any transaction in options listed on a registered national securities exchange for which a broker or dealer acts as a guarantor or en-

dorser of options written by a specialist in a specialist account, the broker or dealer shall deduct, for each account carried or for each class or series of options guaranteed or endorsed, any deficiency in collateral required by paragraph (a)(6) of this section.

(xii)(A) *Deduction from net worth for certain undermargined accounts.* Deducting the amount of cash required in each customer’s or non-customer’s account to meet the maintenance margin requirements of the Examining Authority for the broker or dealer, after application of calls for margin, marks to the market or other required deposits which are outstanding 5 business days or less.

(B) Deducting the amount of cash required in the account of each security-based swap and swap customer to meet the margin requirements of a clearing agency, Examining Authority, the Commission, derivatives clearing organization, or the Commodity Futures Trading Commission, as applicable, after application of calls for margin, marks to the market, or other required deposits which are outstanding within the required time frame to collect the margin, mark to the market, or other required deposits.

(xiii) *Deduction from net worth for indebtedness collateralized by exempted securities.* Deducting, at the option of the broker or dealer, in lieu of including such amounts in aggregate indebtedness, 4 percent of the amount of any indebtedness secured by exempted securities or municipal securities if such indebtedness would otherwise be includable in aggregate indebtedness.

(xiv) *Deduction from net worth for excess deductible amounts related to fidelity bond coverage.* Deducting the amount specified by rule of the Examining Authority for the broker or dealer with respect to a requirement to maintain fidelity bond coverage.

(xv) *Deduction from net worth in lieu of collecting collateral for non-cleared security-based swap and swap transactions—*
(A) *Security-based swaps.* Deducting the initial margin amount calculated pursuant to §240.18a-3(c)(1)(i)(B) for the account of a counterparty at the broker or dealer that is subject to a margin exception set forth in §240.18a-

3(c)(1)(iii), less the margin value of collateral held in the account.

(B) *Swaps*. Deducting the initial margin amount calculated pursuant to the margin rules of the Commodity Futures Trading Commission in the account of a counterparty at the broker or dealer that is subject to a margin exception in those rules, less the margin value of collateral held in the account.

(C) *Treatment of collateral held at a third-party custodian*. For the purposes of the deductions required pursuant to paragraphs (c)(2)(xv)(A) and (B) of this section, collateral held by an independent third-party custodian as initial margin may be treated as collateral held in the account of the counterparty at the broker or dealer if:

(1) The independent third-party custodian is a bank as defined in section 3(a)(6) of the Act or a registered U.S. clearing organization or depository that is not affiliated with the counterparty or, if the collateral consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that is not affiliated with the counterparty and that customarily maintains custody of such foreign securities or currencies;

(2) The broker or dealer, the independent third-party custodian, and the counterparty that delivered the collateral to the custodian have executed an account control agreement governing the terms under which the custodian holds and releases collateral pledged by the counterparty as initial margin that is a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding of any of the parties to the agreement, and that provides the broker or dealer with the right to access the collateral to satisfy the counterparty's obligations to the broker or dealer arising from transactions in the account of the counterparty; and

(3) The broker or dealer maintains written documentation of its analysis that in the event of a legal challenge the relevant court or administrative authorities would find the account control agreement to be legal, valid, binding, and enforceable under the applica-

ble law, including in the event of the receivership, conservatorship, insolvency, liquidation, or a similar proceeding of any of the parties to the agreement.

EXEMPTED SECURITIES

(3) The term *exempted securities* shall mean those securities deemed exempted securities by section 3(a)(12) of the Securities Exchange Act of 1934 and rules thereunder.

CONTRACTUAL COMMITMENTS

(4) The term *contractual commitments* shall include underwriting, when issued, when distributed and delayed delivery contracts, the writing or endorsement of puts and calls and combinations thereof, commitments in foreign currencies, and spot (cash) commodities contracts, but shall not include uncleared regular way purchases and sales of securities and contracts in commodities futures. A series of contracts of purchase or sale of the same security conditioned, if at all, only upon issuance may be treated as an individual commitment.

ADEQUATELY SECURED

(5) Indebtedness shall be deemed to be adequately secured within the meaning of this section when the excess of the market value of the collateral over the amount of the indebtedness is sufficient to make the loan acceptable as a fully secured loan to banks regularly making secured loans to brokers or dealers.

CUSTOMER

(6) The term *customer* shall mean any person from whom, or on whose behalf, a broker or dealer has received, acquired or holds funds or securities for the account of such person, but shall not include a broker or dealer or a registered municipal securities dealer, or a general, special or limited partner or director or officer of the broker or dealer, or any person to the extent that such person has a claim for property or funds which by contract, agreement, or understanding, or by operation of law, is part of the capital of the broker or dealer. *Provided, however*, That the term "customer" shall also include a

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broker or dealer, but only insofar as such broker or dealer maintains a special omnibus account carried with another broker or dealer in compliance with 12 CFR 220.4(b) of Regulation T under the Securities Exchange Act of 1934.

NON-CUSTOMER

(7) The term *non-customer* means a broker or dealer, registered municipal securities dealer, general partner, limited partner, officer, director and persons to the extent their claims are subordinated to the claims of creditors of the broker or dealer.

MARKET MAKER

(8) The term *market maker* shall mean a dealer who, with respect to a particular security, (i) regularly publishes bona fide, competitive bid and offer quotations in a recognized interdealer quotation system; or (ii) furnishes bona fide competitive bid and offer quotations on request; and, (iii) is ready, willing and able to effect transactions in reasonable quantities at his quoted prices with other brokers or dealers.

PROMPTLY TRANSMIT AND DELIVER

(9) A broker or dealer is deemed to “promptly transmit” all funds and to “promptly deliver” all securities within the meaning of paragraphs (a)(2)(i) and (a)(2)(v) of this section where such transmission or delivery is made no later than noon of the next business day after the receipt of such funds or securities; provided, however, that such prompt transmission or delivery shall not be required to be effected prior to the settlement date for such transaction.

PROMPTLY FORWARD

(10) A broker or dealer is deemed to “promptly forward” funds or securities within the meaning of paragraph (a)(2)(i) of this section only when such forwarding occurs no later than noon of the next business day following receipt of such funds or securities.

READY MARKET

(11)(i) The term *ready market* shall include a recognized established securi-

ties market in which there exists independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom.

(ii) A *ready market* shall also be deemed to exist where securities have been accepted as collateral for a loan by a bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934 and where the broker or dealer demonstrates to its Examining Authority that such securities adequately secure such loans as that term is defined in paragraph (c)(5) of this section.

EXAMINING AUTHORITY

(12) The term *Examining Authority* of a broker or dealer shall mean for the purposes of 17 CFR 240.15c3-1 and 240.15c3-1a-d the national securities exchange or national securities association of which the broker or dealer is a member or, if the broker or dealer is a member of more than one such self-regulatory organization, the organization designated by the Commission as the Examining Authority for such broker or dealer, or if the broker or dealer is not a member of any such self-regulatory organization, the Regional Office of the Commission where such broker or dealer has its principal place of business.

ENTITIES THAT HAVE A PRINCIPAL REGULATOR

(13)(i) For purposes of § 240.15c3-1e and § 240.15c3-1g, the term *entity that has a principal regulator* shall mean a person (other than a natural person) that is not a registered broker or dealer (other than a broker or dealer registered under section 15(b)(11) of the Act (15 U.S.C. 78o(b)(11)), provided that the person is:

(A) An insured depository institution as defined in section 3(c)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)(2));

(B) Registered as a futures commission merchant or an introducing

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broker with the Commodity Futures Trading Commission;

(C) Registered with or licensed by a State insurance regulator and issues any insurance, endowment, or annuity policy or contract;

(D) A foreign bank as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7)) that has its headquarters in a jurisdiction for which any foreign bank has been approved by the Board of Governors of the Federal Reserve System to conduct business pursuant to the standards set forth in 12 CFR 211.24(c), provided such foreign bank represents to the Commission that it is subject to the same supervisory regime as the foreign bank previously approved by the Board of Governors of the Federal Reserve System;

(E) Not primarily in the securities business, and the person is:

(1) A corporation organized under section 25A of the Federal Reserve Act (12 U.S.C. 611 through 633); or

(2) A corporation having an agreement or undertaking with the Board of Governors of the Federal Reserve System under section 25 of the Federal Reserve Act (12 U.S.C. 601 through 604a); or

(F) A person that the Commission finds is another entity that is subject to comprehensive supervision, has in place appropriate arrangements so that information that the person provides to the Commission is sufficiently reliable for the purposes of determining compliance with §240.15c3-1e and §240.15c3-1g, and it is appropriate to consider the person to be an entity that has a principal regulator considering all relevant circumstances, including the person's mix of business.

(ii) For purposes of §§240.15c3-1e, 240.15c3-1g, 240.17h-1T, and 240.17h2T, the term *ultimate holding company that has a principal regulator* shall mean a person (other than a natural person) that:

(A) Is a financial holding company or a company that is treated as a financial holding company under the Bank Holding Company Act of 1956 (12 U.S.C. 1840 *et seq.*), or

(B) The Commission determines to be an ultimate holding company that has a principal regulator, if that person is

subject to consolidated, comprehensive supervision; there are in place appropriate arrangements so that information that the person provides to the Commission is sufficiently reliable for the purposes of determining compliance with §240.15c3-1e and §240.15c3-1g; and it is appropriate to consider the person to be an ultimate holding company that has a principal regulator in view of all relevant circumstances, including the person's mix of business.

(14) The term *municipal securities* shall mean those securities included within the definition of "municipal securities" in section 3(a)(29) of the Securities Exchange Act of 1934.

(15) The term *tentative net capital* shall mean the net capital of a broker or dealer before deducting the securities haircuts computed pursuant to paragraph (c)(2)(vi) of this section and the charges on inventory computed pursuant to appendix B to this section (§240.15c3-1b). However, for purposes of paragraph (a)(5) of this section, the term *tentative net capital* means the net capital of an OTC derivatives dealer before deducting the charges for market and credit risk as computed pursuant to appendix F to this section (§240.15c3-1f) or paragraph (c)(2)(vi) of this section, if applicable, and increased by the balance sheet value (including counterparty net exposure) resulting from transactions in eligible OTC derivative instruments which would otherwise be deducted by virtue of paragraph (c)(2)(iv) of this section. For purposes of paragraph (a)(7) of this section, the term *tentative net capital* means the net capital of the broker or dealer before deductions for market and credit risk computed pursuant to §240.15c3-1e or paragraph (c)(2)(vi) of this section, if applicable, and increased by the balance sheet value (including counterparty net exposure) resulting from transactions in derivative instruments which would otherwise be deducted by virtue of paragraph (c)(2)(iv) of this section. Tentative net capital shall include securities for which there is no ready market, as defined in paragraph (c)(11) of this section, if the use of mathematical models has been approved for purposes of calculating deductions from net capital

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for those securities pursuant to § 240.15c3-1e.

INSOLVENT

(16) For the purposes of this section, a broker or dealer is insolvent if the broker or dealer:

(i) Is the subject of any bankruptcy, equity receivership proceeding or any other proceeding to reorganize, conserve, or liquidate such broker or dealer or its property or is applying for the appointment or election of a receiver, trustee, or liquidator or similar official for such broker or dealer or its property;

(ii) Has made a general assignment for the benefit of creditors;

(iii) Is insolvent within the meaning of section 101 of title 11 of the United States Code, or is unable to meet its obligations as they mature, and has made an admission to such effect in writing or in any court or before any agency of the United States or any State; or

(iv) Is unable to make such computations as may be necessary to establish compliance with this section or with § 240.15c3-3.

(17) The term *risk margin amount* means the sum of:

(i) The total initial margin required to be maintained by the broker or dealer at each clearing agency with respect to security-based swap transactions cleared for security-based swap customers; and

(ii) The total initial margin amount calculated by the broker or dealer with respect to non-cleared security-based swaps pursuant to § 240.18a-3(c)(1)(i)(B).

(d) *Debt-equity requirements.* No broker or dealer shall permit the total of outstanding principal amounts of its satisfactory subordination agreements (other than such agreements which qualify under this paragraph (d) as equity capital) to exceed 70 percent of its debt-equity total, as hereinafter defined, for a period in excess of 90 days or for such longer period which the Commission may, upon application of the broker or dealer, grant in the public interest or for the protection of investors. In the case of a corporation, the debt-equity total shall be the sum of its outstanding principal amounts of satisfactory subordination agreements,

par or stated value of capital stock, paid in capital in excess of par, retained earnings, unrealized profit and loss or other capital accounts. In the case of a partnership, the debt-equity total shall be the sum of its outstanding principal amounts of satisfactory subordination agreements, capital accounts of partners (exclusive of such partners' securities accounts) subject to the provisions of paragraph (e) of this section, and unrealized profit and loss. In the case of a sole proprietorship, the debt-equity total shall include the sum of its outstanding principal amounts of satisfactory subordination agreements, capital accounts of the sole proprietorship and unrealized profit and loss. *Provided, however,* That a satisfactory subordination agreement entered into by a partner or stockholder which has an initial term of at least three years and has a remaining term of not less than 12 months shall be considered equity for the purposes of this paragraph (d) if:

(1) It does not have any of the provisions for accelerated maturity provided for by paragraphs (b)(9)(i), (10)(i) or (10)(ii) of Appendix (D) (17 CFR 240.15c3-1d) and is maintained as capital subject to the provisions restricting the withdrawal thereof required by paragraph (e) of this section or

(2) The partnership agreement provides that capital contributed pursuant to a satisfactory subordination agreement as defined in Appendix (D) (17 CFR 240.15c3-1d) shall in all respects be partnership capital subject to the provisions restricting the withdrawal thereof required by paragraph (e) of this section.

(e)(1) *Notice provisions relating to limitations on the withdrawal of equity capital.* No equity capital of the broker or dealer or a subsidiary or affiliate consolidated pursuant to appendix C (17 CFR 240.15c3-1c) may be withdrawn by action of a stockholder or a partner or by redemption or repurchase of shares of stock by any of the consolidated entities or through the payment of dividends or any similar distribution, nor may any unsecured advance or loan be made to a stockholder, partner, sole proprietor, employee or affiliate without written notice given in accordance

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with paragraph (e)(1)(iv) of this section:

(i) Two business days prior to any withdrawals, advances or loans if those withdrawals, advances or loans on a net basis exceed in the aggregate in any 30 calendar day period, 30 percent of the broker or dealer's excess net capital. A broker or dealer, in an emergency situation, may make withdrawals, advances or loans that on a net basis exceed 30 percent of the broker or dealer's excess net capital in any 30 calendar day period without giving the advance notice required by this paragraph, with the prior approval of its Examining Authority. Where a broker or dealer makes a withdrawal with the consent of its Examining Authority, it shall in any event comply with paragraph (e)(1)(ii) of this section; or

(ii) Two business days after any withdrawals, advances or loans if those withdrawals, advances or loans on a net basis exceed in the aggregate in any 30 calendar day period, 20 percent of the broker or dealer's excess net capital.

(iii) This paragraph (e)(1) does not apply to:

(A) Securities or commodities transactions in the ordinary course of business between a broker or dealer and an affiliate where the broker or dealer makes payment to or on behalf of such affiliate for such transaction and then receives payment from such affiliate for the securities or commodities transaction within two business days from the date of the transaction; or

(B) Withdrawals, advances or loans which in the aggregate in any thirty calendar day period, on a net basis, equal \$500,000 or less.

(iv) Each required notice shall be effective when received by the Commission in Washington, DC, the regional office of the Commission for the region in which the broker or dealer has its principal place of business, the broker or dealer's Examining Authority and the Commodity Futures Trading Commission if such broker or dealer is registered with that Commission.

(2) *Limitations on Withdrawal of equity capital.* No equity capital of the broker or dealer or a subsidiary or affiliate consolidated pursuant to appendix C (17

CFR 240.15c3-1c) may be withdrawn by action of a stockholder or a partner or by redemption or repurchase of shares of stock by any of the consolidated entities or through the payment of dividends or any similar distribution, nor may any unsecured advance or loan be made to a stockholder, partner, sole proprietor, employee or affiliate, if after giving effect thereto and to any other such withdrawals, advances or loans and any Payments of Payment Obligations (as defined in appendix D (17 CFR 240.15c3-1d)) under satisfactory subordination agreements which are scheduled to occur within 180 days following such withdrawal, advance or loan if:

(i) The broker or dealer's net capital would be less than 120 percent of the minimum dollar amount required by paragraph (a) of this section;

(ii) The broker-dealer is registered as a futures commission merchant, its net capital would be less than 7 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account);

(iii) The broker-dealer's net capital would be less than 25 percent of deductions from net worth in computing net capital required by paragraphs (c)(2)(vi), (f) and appendix A, of this section, unless the broker or dealer has the prior approval of the Commission to make such withdrawal;

(iv) The total outstanding principal amounts of satisfactory subordination agreements of the broker or dealer and any subsidiaries or affiliates consolidated pursuant to appendix C (17 CFR 240.15c3-1c) (other than such agreements which qualify as equity under paragraph (d) of this section) would exceed 70% of the debt-equity total as defined in paragraph (d) of this section;

(v) The broker or dealer is subject to the aggregate indebtedness limitations of paragraph (a) of this section, the aggregate indebtedness of any of the consolidated entities exceeds 1000 percent of its net capital; or

(vi) The broker or dealer is subject to the alternative net capital requirement of paragraph (f) of this section, its net capital would be less than 5 percent of aggregate debit items computed in accordance with 17 CFR 240.15c3-3a.

(3)(i) *Temporary restrictions on withdrawal of net capital.* The Commission may by order restrict, for a period of up to twenty business days, any withdrawal by the broker or dealer of equity capital or unsecured loan or advance to a stockholder, partner, sole proprietor, member, employee or affiliate under such terms and conditions as the Commission deems necessary or appropriate in the public interest or consistent with the protection of investors if the Commission, based on the information available, concludes that such withdrawal, advance or loan may be detrimental to the financial integrity of the broker or dealer, or may unduly jeopardize the broker or dealer's ability to repay its customer claims or other liabilities which may cause a significant impact on the markets or expose the customers or creditors of the broker or dealer to loss without taking into account the application of the Securities Investor Protection Act of 1970.

(ii) An order temporarily prohibiting the withdrawal of capital shall be rescinded if the Commission determines that the restriction on capital withdrawal should not remain in effect. A hearing on an order temporarily prohibiting the withdrawal of capital will be held within two business days from the date of the request in writing by the broker or dealer.

(4)(i) *Miscellaneous provisions.* Excess net capital is that amount in excess of the amount required under paragraph (a) of this section. For the purposes of paragraphs (e)(1) and (e)(2) of this section, a broker or dealer may use the amount of excess net capital and deductions required under paragraphs (c)(2)(vi), (f) and appendix A of this section reported in its most recently required filed Form X-17A-5 for the purposes of calculating the effect of a projected withdrawal, advance or loan relative to excess net capital or deductions. The broker or dealer must assure itself that the excess net capital or the deductions reported on the most re-

cently required filed Form X-17A-5 have not materially changed since the time such report was filed.

(ii) The term equity capital includes capital contributions by partners, par or stated value of capital stock, paid-in capital in excess of par, retained earnings or other capital accounts. The term equity capital does not include securities in the securities accounts of partners and balances in limited partners' capital accounts in excess of their stated capital contributions.

(iii) Paragraphs (e)(1) and (e)(2) of this section shall not preclude a broker or dealer from making required tax payments or preclude the payment to partners of reasonable compensation, and such payments shall not be included in the calculation of withdrawals, advances, or loans for purposes of paragraphs (e)(1) and (e)(2) of this section.

(iv) For the purpose of this paragraph (e) of this section, any transaction between a broker or dealer and a stockholder, partner, sole proprietor, employee or affiliate that results in a diminution of the broker or dealer's net capital shall be deemed to be an advance or loan of net capital.

[40 FR 29799, July 16, 1975]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 240.15c3-1, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at www.govinfo.gov.

§ 240.15c3-1a Options (Appendix A to 17 CFR 240.15c3-1).

(a) *Definitions.* (1) The term *unlisted option* shall mean any option not included in the definition of listed option provided in paragraph (c)(2)(x) of § 240.15c3-1.

(2) The term *option series* refers to listed option contracts of the same type (either a call or a put) and exercise style, covering the same underlying security with the same exercise price, expiration date, and number of underlying units.

(3) The term *related instrument* within an option class or product group refers to futures contracts, options on futures contracts, security-based swaps on a narrow-based security index, and swaps covering the same underlying instrument. In relation to options on foreign

currencies, a related instrument within an option class also shall include forward contracts on the same underlying currency.

(4) The term *underlying instrument* refers to long and short positions, as appropriate, covering the same foreign currency, the same security, security future, or security-based swap other than a security-based swap on a narrow-based security index, or a security which is exchangeable for or convertible into the underlying security within a period of 90 days. If the exchange or conversion requires the payment of money or results in a loss upon conversion at the time when the security is deemed an underlying instrument for purposes of this section, the broker or dealer will deduct from net worth the full amount of the conversion loss. The term *underlying instrument* shall not be deemed to include securities options, futures contracts, options on futures contracts, security-based swaps on a narrow-based security index, qualified stock baskets, unlisted instruments, or swaps.

(5) The term *options class* refers to all options contracts covering the same underlying instrument.

(6) The term *product group* refers to two or more option classes, related instruments, underlying instruments, and qualified stock baskets in the same portfolio type (see paragraph (b)(1)(ii) of this section) for which it has been determined that a percentage of offsetting profits may be applied to losses at the same valuation point.

(b) The deduction under this Appendix A to §240.15c3-1 shall equal the sum of the deductions specified in paragraphs (b)(1)(v)(C) or (b)(2) of this section.

THEORETICAL PRICING CHARGES

(1)(i) *Definitions.* (A) The terms *theoretical gains and losses* shall mean the gain and loss in the value of individual option series, the value of underlying instruments, related instruments, and qualified stock baskets within that option's class, at 10 equidistant intervals (valuation points) ranging from an assumed movement (both up and down) in the current market value of the underlying instrument equal to the percentage corresponding to the deduc-

tions otherwise required under §240.15c3-1 for the underlying instrument (See paragraph (a)(1)(iii) of this section). Theoretical gains and losses shall be calculated using a theoretical options pricing model that satisfies the criteria set forth in paragraph (a)(1)(i)(B) of this section.

(B) The term *theoretical options pricing model* shall mean any mathematical model, other than a broker-dealer proprietary model, approved by a Designated Examining Authority. Such Designated Examining Authority shall submit the model to the Commission, together with a description of its methods for approving models. Any such model shall calculate theoretical gains and losses as described in paragraph (a)(1)(i)(A) of this section for all series and issues of equity, index and foreign currency options and related instruments, and shall be made available equally and on the same terms to all registered brokers or dealers. Its procedures shall include the arrangement of the vendor to supply accurate and timely data to each broker-dealer with respect to its services, and the fees for distribution of the services. The data provided to brokers or dealers shall also contain the minimum requirements set forth in paragraphs (b)(1)(v)(C) of this section and the product group offsets set forth in paragraphs (b)(1)(v)(B) of this section. At a minimum, the model shall consider the following factors in pricing the option:

(1) The current spot price of the underlying asset;

(2) The exercise price of the option;

(3) The remaining time until the option's expiration;

(4) The volatility of the underlying asset;

(5) Any cash flows associated with ownership of the underlying asset that can reasonably be expected to occur during the remaining life of the option; and

(6) The current term structure of interest rates.

(C) The term *major market foreign currency* shall mean the currency of a sovereign nation for which there is a substantial inter-bank forward currency market.

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(D) The term *qualified stock basket* shall mean a set or basket of stock positions which represents no less than 50% of the capitalization for a high-capitalization or non-high-capitalization diversified market index, or, in the case of a narrow-based index, no less than 95% of the capitalization for such narrow-based index.

(ii) With respect to positions involving listed options in a single specialist's market-maker account, and, separately, with respect to positions involving listed option positions in its proprietary or other account, the broker or dealer shall group long and short positions into the following portfolio types:

(A) Equity options on the same underlying instrument and positions in that underlying instrument;

(B) Options on the same major market foreign currency, positions in that major market foreign currency, and related instruments within those options' classes;

(C) High-capitalization diversified market index options, related instruments within the option's class, and qualified stock baskets in the same index;

(D) Non-high-capitalization diversified index options, related instruments within the index option's class, and qualified stock baskets in the same index; and

(E) Narrow-based index options, related instruments within the index option's class, and qualified stock baskets in the same index.

(iii) Before making the computation, each broker or dealer shall obtain the theoretical gains and losses for each options series and for the related and underlying instruments within those options' class in each specialist's market-maker account guaranteed, endorsed, or carried by a broker or dealer, or in the proprietary or other accounts of that broker or dealer. For each option series, the theoretical options pricing model shall calculate theoretical prices at 10 equidistant valuation points within a range consisting of an increase or a decrease of the following percentages of the daily market price of the underlying instrument:

(A) + (-)15% for equity securities with a ready market, narrow-based in-

dexes, and non-high-capitalization diversified indexes;

(B) + (-)6% for major market foreign currencies;

(C) + (-) 20% for all other currencies; and

(D) + (-)10% for high-capitalization diversified indexes.

(iv) As to non-clearing option specialists and market-makers, the percentages of the daily market price of the underlying instrument shall be:

(A) + (-) 4½% for major market foreign currencies; and

(B) + (-)8% for high-capitalization diversified indexes.

(C) + (-) 10% for a non-clearing market-maker, or specialist in non-high capitalization diversified index product group.

(v)(A) The broker or dealer shall multiply the corresponding theoretical gains and losses at each of the 10 equidistant valuation points by the number of positions held in a particular options series, the related instruments and qualified stock baskets within the option's class, and the positions in the same underlying instrument.

(B) In determining the aggregate profit or loss for each portfolio type, the broker or dealer will be allowed the following offsets in the following order, provided, that in the case of qualified stock baskets, the broker or dealer may elect to net individual stocks between qualified stock baskets and take the appropriate deduction on the remaining, if any, securities:

(1) First, a broker or dealer is allowed the following offsets within an option's class:

(i) Between options on the same underlying instrument, positions covering the same underlying instrument, and related instruments within the option's class, 100% of a position's gain shall offset another position's loss at the same valuation point;

(ii) Between index options, related instruments within the option's class, and qualified stock baskets on the same index, 95%, or such other amount as designated by the Commission, of gains shall offset losses at the same valuation point;

(2) Second, a broker-dealer is allowed the following offsets within an index product group:

(i) Among positions involving different high-capitalization diversified index option classes within the same product group, 90% of the gain in a high-capitalization diversified market index option, related instruments, and qualified stock baskets within that index option's class shall offset the loss at the same valuation point in a different high-capitalization diversified market index option, related instruments, and qualified stock baskets within that index option's class;

(ii) Among positions involving different non-high-capitalization diversified index option classes within the same product group, 75% of the gain in a non-high-capitalization diversified market index option, related instruments, and qualified stock baskets within that index option's class shall offset the loss at the same valuation point in another non-high-capitalization diversified market index option, related instruments, and qualified stock baskets within that index option's class or product group;

(iii) Among positions involving different narrow-based index option classes within the same product group, 90% of the gain in a narrow-based market index option, related instruments, and qualified stock baskets within that index option's class shall offset the loss at the same valuation point in another narrow-based market index option, related instruments, and qualified stock baskets within that index option's class or product group;

(iv) No qualified stock basket should offset another qualified stock basket; and

(3) Third, a broker-dealer is allowed the following offsets between product groups: Among positions involving different diversified index product groups within the same market group, 50% of the gain in a diversified market index option, a related instrument, or a qualified stock basket within that index option's product group shall offset the loss at the same valuation point in another product group;

(C) For each portfolio type, the total deduction shall be the larger of:

(1) The amount for any of the 10 equidistant valuation points representing the largest theoretical loss after apply-

ing the offsets provided in paragraph (b)(1)(v)(B) if this section; or

(2) A minimum charge equal to 25% times the multiplier for each equity and index option contract and each related instrument within the option's class or product group, or \$25 for each option on a major market foreign currency with the minimum charge for futures contracts and options on futures contracts adjusted for contract size differentials, not to exceed market value in the case of long positions in options and options on futures contracts; plus

(3) In the case of portfolio types involving index options and related instruments offset by a qualified stock basket, there will be a minimum charge of 5 percent of the market value of the qualified stock basket for high-capitalization diversified and narrow-based indexes;

(4) In the case of portfolio types involving index options and related instruments offset by a qualified stock basket, there will be a minimum charge of 7 ½ percent of the market value of the qualified stock basket for non-high-capitalization diversified indexes; and

(5) In the case of portfolio types involving security futures and equity options on the same underlying instrument and positions in that underlying instrument, there will be a minimum charge of 25 percent times the multiplier for each security future and equity option.

ALTERNATIVE STRATEGY BASED METHOD

(2) A broker or dealer may elect to apply the alternative strategy based method in accordance with the provisions of this paragraph (b)(2).

(i) *Definitions.* (A) The term *intrinsic value* or *in-the-money amount* shall mean the amount by which the exercise value, in the case of a call, is less than the current market value of the underlying instrument, and, in the case of a put, is greater than the current market value of the underlying instrument.

(B) The term *out-of-the-money amount* shall mean the amount by which the exercise value, in the case of a call, is greater than the current market value of the underlying instrument, and, in

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the case of a put, is less than the current market value of the underlying instrument.

(C) The term *time value* shall mean the current market value of an option contract that is in excess of its intrinsic value.

(ii) Every broker or dealer electing to calculate adjustments to net worth in accordance with the provisions of this paragraph (b)(2) must make the following adjustments to net worth:

(A) Add the time value of a short position in a listed option; and

(B) Deduct the time value of a long position in a listed option, which relates to a position in the same underlying instrument or in a related instrument within the option class or product group as recognized in the strategies enumerated in paragraph (b)(2)(iii)(D) of this section; and

(C) Add the net short market value or deduct the long market value of listed options as recognized in the strategies enumerated in paragraphs (b)(2)(iii)(E)(I) and (2) of this section.

(iii) In computing net capital after the adjustments provided for in paragraph (b)(2)(ii) of this section, every broker or dealer shall deduct the percentages specified in this paragraph (b)(2)(iii) for all listed option positions, positions covering the same underlying instrument and related instruments within the options' class or product group.

UNCOVERED CALLS

(A) Where a broker or dealer is short a call, deducting the percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3-1 of the current market value of the underlying instrument for such option reduced by its out-of-the-money amount, to the extent that such reduction does not operate to increase net capital. In no event shall this deduction be less than the greater of \$250 for each short call option contract for 100 shares or 50% of the aforementioned percentage.

UNCOVERED PUTS

(B) Where a broker or dealer is short a put, deducting the percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3-1 of the current market value of the underlying in-

strument for such option reduced by its out-of-the-money amount, to the extent that such reduction does not operate to increase net capital. In no event shall the deduction provided by this paragraph be less than the greater of \$250 for each short put option contract for 100 shares or 50% of the aforementioned percentage.

LONG POSITIONS

(C) Where a broker or dealer is long puts or calls, deducting 50 percent of the market value of the net long put and call positions in the same options series.

CERTAIN SECURITY POSITIONS WITH OFFSETTING OPTIONS

(D)(I) Where a broker or dealer is long a put for which it has an offsetting long position in the same number of units of the same underlying instrument, deducting the percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3-1 of the current market value of the underlying instrument for the long offsetting position, not to exceed the out-of-the-money amount of the option. In no event shall the deduction provided by this paragraph be less than \$25 for each option contract for 100 shares, provided that the minimum charge need not exceed the intrinsic value of the option.

(2) Where a broker or dealer is long a call for which it has an offsetting short position in the same number of units of the same underlying instrument, deducting the percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3-1 of the current market value of the underlying instrument for the short offsetting position, not to exceed the out-of-the-money amount of the option. In no event shall the deduction provided by this paragraph be less than \$25 for each option contract for 100 shares, provided that the minimum charge need not exceed the intrinsic value of the option.

(3) Where a broker or dealer is short a call for which it has an offsetting long position in the same number of units of the same underlying instrument, deducting the percentage required by paragraphs (c)(2)(vi) (A)

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through (K) of § 240.15c3-1 of the current market value of the underlying instrument for the offsetting long position reduced by the short call's intrinsic value. In no event shall the deduction provided by this paragraph be less than \$25 for each option contract for 100 shares.

CERTAIN SPREAD POSITIONS

(E)(1) Where a broker or dealer is short a listed call and is also long a listed call in the same class of options contracts and the long option expires on the same date as or subsequent to the short option, the deduction, after adjustments required in paragraph (b) of this section, shall be the amount by which the exercise value of the long call exceeds the exercise value of the short call. If the exercise value of the long call is less than or equal to the exercise value of the short call, no deduction is required.

(2) Where a broker or dealer is short a listed put and is also long a listed put in the same class of options contracts and the long option expires on the same date as or subsequent to the short option, the deduction, after the adjustments required in paragraph (b) of this section, shall be the amount by which the exercise value of the short put exceeds the exercise value of the long put. If the exercise value of the long put is equal to or greater than the exercise value of the short put, no deduction is required.

(c) With respect to transactions involving unlisted options, every broker or dealer shall determine the value of unlisted option positions in accordance with the provision of paragraph (c)(2)(i) of § 240.15c3-1, and shall deduct the percentages of all securities positions or unlisted options in the proprietary or other accounts of the broker or dealer specified in this paragraph (c). However, where computing the deduction required for a security position as if the security position had no related unlisted option position and positions in unlisted options as if uncovered would result in a lesser deduction from net worth, the broker or dealer may compute such deductions separately.

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UNCOVERED CALLS

(1) Where a broker or dealer is short a call, deducting 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3-1) of the current market value of the security underlying such option reduced by any excess of the exercise value of the call over the current market value of the underlying security. In no event shall the deduction provided by this paragraph be less than \$250 for each option contract for 100 shares.

UNCOVERED PUTS

(2) Where a broker or dealer is short a put, deducting 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3-1) of the current market value of the security underlying the option reduced by any excess of the market value of the underlying security over the exercise value of the put. In no event shall the deduction provided by this paragraph be less than \$250 for each option contract for 100 shares.

COVERED CALLS

(3) Where a broker or dealer is short a call and long equivalent units of the underlying security, deducting 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3-1) of the current market value of the underlying security reduced by any excess of the current market value of the underlying security over the exercise value of the call. No reduction under this paragraph shall have the effect of increasing net capital.

COVERED PUTS

(4) Where a broker or dealer is short a put and short equivalent units of the underlying security, deducting 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3-1) of the current market value of the underlying security reduced by any excess of the exercise value of the put over the market value of the underlying security. No such reduction shall have the effect of increasing net capital.

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CONVERSION ACCOUNTS

(5) Where a broker or dealer is long equivalent units of the underlying security, long a put written or endorsed by a broker or dealer and short a call in its proprietary or other accounts, deducting 5 percent (or 50 percent of such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3-1) of the current market value of the underlying security.

(6) Where a broker or dealer is short equivalent units of the underlying security, long a call written or endorsed by a broker or dealer and short a put in his proprietary or other accounts, deducting 5 percent (or 50 percent of such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3-1) of the market value of the underlying security.

LONG OPTIONS

(7) Where a broker or dealer is long a put or call endorsed or written by a broker or dealer, deducting 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3-1) of the market value of the underlying security, not to exceed any value attributed to such option in paragraph (c)(2)(i) of § 240.15c3-1.

[62 FR 6481, Feb. 12, 1997, as amended at 78 FR 51901, Aug. 21, 2013; 79 FR 1549, Jan. 8, 2014; 84 FR 44044, Aug. 22, 2019]

§ 240.15c3-1b Adjustments to net worth and aggregate indebtedness for certain commodities transactions (appendix B to 17 CFR 240.15c3-1).

(a) Every broker or dealer in computing net capital pursuant to 17 CFR 240.15c3-1 shall comply with the following:

(1) Where a broker or dealer has an asset or liability which is treated or defined in paragraph (c) of 17 CFR 240.15c3-1, the inclusion or exclusion of all or part of such asset or liability for the computation of aggregate indebtedness and net capital shall be in accordance with paragraph (c) of 17 CFR 240.15c3-1, except as specifically provided otherwise in this appendix B. Where a commodity related asset or liability is specifically treated or defined in 17 CFR 1.17 and is not generally or

specifically treated or defined in 17 CFR 240.15c3-1 or this appendix B, the inclusion or exclusion of all or part of such asset or liability for the computation of aggregate indebtedness and net capital shall be in accordance with 17 CFR 1.17.

AGGREGATE INDEBTEDNESS

(2) The term *aggregate indebtedness* as defined in paragraph (c)(1) of this section shall exclude with respect to commodity-related transactions:

(i) Indebtedness arising in connection with an advance to a non-proprietary account when such indebtedness is adequately collateralized by spot commodities eligible for delivery on a contract market and when such spot commodities are covered.

(ii) Advances received by the broker or dealer against bills of lading issued in connection with the shipment of commodities sold by the broker or dealer; and

(iii) Equity balances in the accounts of general partners.

NET CAPITAL

(3) In computing net capital as defined in paragraph (c)(2) of this section, the net worth of a broker or dealer shall be adjusted as follows with respect to commodity-related transactions:

(i) *Unrealized profit or loss for certain commodities transactions.* (A) Unrealized profits shall be added and unrealized losses shall be deducted in the commodities accounts of the broker or dealer, including unrealized profits and losses on fixed price commitments and forward contracts; and

(B) The value attributed to any commodity option which is not traded on a contract market shall be the difference between the option's strike price and the market value for the physical or futures contract which is the subject of the option. In the case of a long call commodity option, if the market value for the physical or futures contract which is the subject of the option is less than the strike price of the option, it shall be given no value. In the case of a long put commodity option, if the market value for the physical commodity or futures contract which is the subject of the option is more than the

striking price of the option, it shall be given no value.

(ii) Deduct any unsecured commodity futures or option account containing a ledger balance and open trades, the combination of which liquidates to a deficit or containing a debit ledger balance only: *Provided, however*, Deficits or debit ledger balances in unsecured customers', non-customers' and proprietary accounts, which are the subject of calls for margin or other required deposits need not be deducted until the close of business on the business day following the date on which such deficit or debit ledger balance originated;

(iii) Deduct all unsecured receivables, advances and loans except for:

(A) Management fees receivable from commodity pools outstanding no longer than thirty (30) days from the date they are due;

(B) Receivables from foreign clearing organizations;

(C) Receivables from registered futures commission merchants or brokers, resulting from cleared swap transactions or, commodity futures or option transactions, except those specifically excluded under paragraph (3)(ii) of this appendix B. In the case of an introducing broker or an applicant for registration as an introducing broker, include 50 percent of the value of a guarantee or security deposit with a futures commission merchant which carries or intends to carry accounts for the customers of the introducing broker.

(iv) Deduct all inventories (including work in process, finished goods, raw materials and inventories held for resale) except for readily marketable spot commodities; or spot commodities which adequately collateralize indebtedness under paragraph (c)(7) of 17 CFR 1.17;

(v) Guarantee deposits with commodities clearing organizations are not required to be deducted from net worth;

(vi) Stock in commodities clearing organizations to the extent of its margin value is not required to be deducted from net worth;

(vii) Deduct from net worth the amount by which any advances paid by the broker or dealer on cash commodity contracts and used in computing net capital exceeds 95 percent of

the market value of the commodities covered by such contracts.

(viii) Do not include equity in the commodity accounts of partners in net worth.

(ix) In the case of all inventory, fixed price commitments and forward contracts, except for inventory and forward contracts in the inter-bank market in those foreign currencies which are purchased or sold for further delivery on or subject to the rules of a contract market and covered by an open futures contract for which there will be no charge, deduct the applicable percentage of the net position specified below:

(A) Inventory which is currently registered as deliverable on a contract market and covered by an open futures contract or by a commodity option on a physical—No charge.

(B) Inventory which is covered by an open futures contract or commodity option—5% of the market value.

(C) Inventory which is not covered—20% of the market value.

(D) Fixed price commitments (open purchases and sales) and forward contracts which are covered by an open futures contract or commodity option—10% of the market value.

(E) Fixed price commitments (open purchases and sales) and forward contracts which are not covered by an open futures contract or commodity option—20% of the market value.

(x) Deduct 4% of the market value of commodity options granted (sold) by option customers on or subject to the rules of a contract market.

(xi) [Reserved]

(xii) Deduct for undermargined customer commodity futures accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or, if there are no such maintenance margin requirements, clearing organization margin requirements applicable to such positions, after application of calls for margin, or other required deposits which are outstanding three business days or less. If there are no such maintenance margin requirements or clearing organization margin requirements on such accounts, then deduct the amount of funds required to provide margin equal to the amount

necessary after application of calls for margin, or other required deposits outstanding three days or less to restore original margin when the original margin has been depleted by 50 percent or more. *Provided*, To the extent a deficit is deducted from net worth in accordance with paragraph (a)(3)(ii) of this appendix B, such amount shall not also be deducted under this paragraph (a)(3)(xii). In the event that an owner of a customer account has deposited an asset other than cash to margin, guarantee or secure his account, the value attributable to such asset for purposes of this paragraph shall be the lesser of (A) the value attributable to such asset pursuant to the margin rules of the applicable board of trade, or (B) the market value of such asset after application of the percentage deductions specified in paragraph (a)(3)(ix) of this appendix B or, where appropriate, specified in paragraph (c)(2)(vi) or (c)(2)(vii) of § 240.15c3-1 this chapter;

(xiii) Deduct for undermargined non-customer and omnibus commodity futures accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or, if there are no such maintenance margin requirements, clearing organization margin requirements applicable to such positions, after application of calls for margin, or other required deposits which are outstanding two business days or less. If there are no such maintenance margin requirements or clearing organization margin requirements, then deduct the amount of funds required to provide margin equal to the amount necessary after application of calls for margin, or other required deposits outstanding two days or less to restore original margin when the original margin has been depleted by 50 percent or more. *Provided*, To the extent a deficit is deducted from net worth in accordance with paragraph (a)(3)(ii) of this appendix B such amount shall not also be deducted under this paragraph (a)(3)(xiii). In the event that an owner of a non-customer or omnibus account has deposited an asset other than cash to margin, guarantee or secure his account, the value attributable to such asset for purposes of this paragraph shall be the lesser of

(A) the value attributable to such asset pursuant to the margin rules of the applicable board of trade, or (B) the market value of such asset after application of the percentage deductions specified in paragraph (a)(3)(ix) of this appendix B or, where appropriate, specified in paragraph (c)(2)(vi) or (c)(2)(vii) of § 240.15c3-1 of this chapter;

(xiv) In the case of open futures contracts and granted (sold) commodity options held in proprietary accounts carried by the broker or dealer which are not covered by a position held by the broker or dealer or which are not the result of a "changer trade made in accordance with the rules of a contract market, deduct:

(A) For a broker or dealer which is a clearing member of a contract market for the positions on such contract market cleared by such member, the applicable margin requirement of the applicable clearing organization;

(B) For a broker or dealer which is a member of a self-regulatory organization 150% of the applicable maintenance margin requirement of the applicable board of trade or clearing organization, whichever is greater; or

(C) For all other brokers or dealers, 200% of the applicable maintenance margin requirement of the applicable board of trade or clearing organization, whichever is greater; or

(D) For open contracts or granted (sold) commodity options for which there are no applicable maintenance margin requirements, 200% of the applicable initial margin requirement;

Provided, the equity in any such proprietary account shall reduce the deduction required by this paragraph (a)(3)(xiv) if such equity is not otherwise includable in net capital.

(xv) In the case of a broker or dealer which is a purchaser of a commodity option which is traded on a contract market the deduction shall be the same safety factor as if the broker or dealer were the grantor of such option in accordance with paragraph (a)(3)(xiv), but in no event shall the safety factor be greater than the market value attributed to such option.

(xvi) In the case of a broker or dealer which is a purchaser of a commodity option not traded on a contract market which has value and such value is used

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to increase net capital, the deduction is ten percent of the market value of the physical or futures contract which is the subject of such option but in no event more than the value attributed to such option.

(xvii) Deduction 5% of all unsecured receivables includable under paragraph (a)(3)(iii)(C) of this appendix B used by the broker or dealer in computing “net capital” and which are not receivable from (A) a futures commission merchant registered as such with the Commodity Futures Trading Commission, or (B) a broker or dealer which is registered as such with the Securities and Exchange Commission.

(xviii) A loan or advance or any other form of receivable shall not be considered “secured” for the purposes of paragraph (a)(3) of this appendix B unless the following conditions exist:

(A) The receivable is secured by readily marketable collateral which is otherwise unencumbered and which can be readily converted into cash: *Provided, however,* That the receivable will be considered secured only to the extent of the market value of such collateral after application of the percentage deductions specified in paragraph (a)(3)(ix) of this appendix B; and

(B)(1) The readily marketable collateral is in the possession or control of the broker or dealer; or

(2) The broker or dealer has a legally enforceable, written security agreement, signed by the debtor, and has a perfected security interest in the readily marketable collateral within the meaning of the laws of the State in

which the readily marketable collateral is located.

(xix) The term *cover* for purposes of this appendix B shall mean cover as defined in 17 CFR 1.17(j).

(xx) The term *customer* for purposes of this Appendix B shall mean customer as defined in 17 CFR 1.17(b)(2). The term “non-customer” for purposes of this appendix B shall mean non-customer as defined in 17 CFR 1.17(b)(4).

(b) Every broker or dealer in computing net capital pursuant to §240.15c3-1 must comply with the following:

(1) *Cleared swaps.* In the case of a cleared swap held in a proprietary account of the broker or dealer, deducting the amount of the applicable margin requirement of the derivatives clearing organization or, if the swap references an equity security index, the broker or dealer may take a deduction using the method specified in §240.15c3-1a.

(2) *Non-cleared swaps—(i) Credit default swaps referencing broad-based security indices.* In the case of a non-cleared credit default swap for which the deductions in §240.15c3-1e do not apply:

(A) *Short positions (selling protection).* In the case of a non-cleared swap that is a short credit default swap referencing a broad-based security index, deducting the percentage of the notional amount based upon the current basis point spread of the credit default swap and the maturity of the credit default swap in accordance table 1 to §240.15c3-1a(b)(2)(i)(A):

TABLE 1 TO § 240.15c3-1a(b)(2)(i)(A)

| Length of time to maturity of credit default swap contract | Basis point spread | | | | | |
|--|--------------------|-------------|-------------|-------------|-------------|-----------------|
| | 100 or less (%) | 101-300 (%) | 301-400 (%) | 401-500 (%) | 501-699 (%) | 700 or more (%) |
| Less than 12 months | 0.67 | 1.33 | 3.33 | 5.00 | 6.67 | 10.00 |
| 12 months but less than 24 months | 1.00 | 2.33 | 5.00 | 6.67 | 8.33 | 11.67 |
| 24 months but less than 36 months | 1.33 | 3.33 | 6.67 | 8.33 | 10.00 | 13.33 |
| 36 months but less than 48 months | 2.00 | 4.00 | 8.33 | 10.00 | 11.67 | 15.00 |
| 48 months but less than 60 months | 2.67 | 4.67 | 10.00 | 11.67 | 13.33 | 16.67 |
| 60 months but less than 72 months | 3.67 | 5.67 | 11.67 | 13.33 | 15.00 | 18.33 |
| 72 months but less than 84 months | 4.67 | 6.67 | 13.33 | 15.00 | 16.67 | 20.00 |
| 84 months but less than 120 months | 5.67 | 10.00 | 15.00 | 16.67 | 18.33 | 26.67 |
| 120 months and longer | 6.67 | 13.33 | 16.67 | 18.33 | 20.00 | 33.33 |

(B) *Long positions (purchasing protection).* In the case of a non-cleared swap that is a long credit default swap ref-

erencing a broad-based security index, deducting 50 percent of the deduction that would be required by paragraph

(b)(2)(i)(A) of this section if the non-cleared swap was a short credit default swap, each such deduction not to exceed the current market value of the long position.

(C) *Long and short credit default swaps.* In the case of non-cleared swaps that are long and short credit default swaps referencing the same broad-based security index, have the same credit events which would trigger payment by the seller of protection, have the same basket of obligations which would determine the amount of payment by the seller of protection upon the occurrence of a credit event, that are in the same or adjacent spread category, and that are in the same or adjacent maturity category and have a maturity date within three months of the other maturity category, deducting the percentage of the notional amount specified in the higher maturity category under paragraph (b)(2)(i)(A) or (B) of this section on the excess of the long or short position.

(D) *Long basket of obligors and long credit default swap.* In the case of a non-cleared swap that is a long credit default swap referencing a broad-based security index and the broker or dealer is long a basket of debt securities comprising all of the components of the security index, deducting 50 percent of the amount specified in § 240.15c3-1(c)(2)(vi) for the component securities, provided the broker or dealer can deliver the component securities to satisfy the obligation of the broker or dealer on the credit default swap.

(E) *Short basket of obligors and short credit default swap.* In the case of a non-cleared swap that is a short credit default swap referencing a broad-based security index and the broker or dealer is short a basket of debt securities comprising all of the components of the security index, deducting the amount specified in § 240.15c3-1(c)(2)(vi) for the component securities.

(ii) *All other swaps.* (A) In the case of a non-cleared swap that is not a credit default swap for which the deductions in § 240.15c3-1e do not apply, deducting the amount calculated by multiplying the notional value of the swap by the percentage specified in:

(1) Section 240.15c3-1 applicable to the reference asset if § 240.15c3-1 speci-

fies a percentage deduction for the type of asset;

(2) 17 CFR 1.17 applicable to the reference asset if 17 CFR 1.17 specifies a percentage deduction for the type of asset and § 240.15c3-1 does not specify a percentage deduction for the type of asset; or

(3) In the case of non-cleared interest rate swap, § 240.15c3-1(c)(2)(vi)(A) based on the maturity of the swap, provided that the percentage deduction must be no less than one eighth of 1 percent of the amount of a long position that is netted against a short position in the case of a non-cleared swap with a maturity of three months or more.

(B) A broker or dealer may reduce the deduction under paragraph (b)(2)(ii)(A) by an amount equal to any reduction recognized for a comparable long or short position in the reference asset or interest rate under § 240.15c3-1 or 17 CFR 1.17.

(Secs. 15(c)(3), 17(a) and 23(a), 15 U.S.C. 78o(c)(3), 78q(a), and 78w(a))

[44 FR 34886, June 15, 1979, as amended at 46 FR 37041, July 17, 1981; 49 FR 31848, Aug. 9, 1984; 84 FR 44044, Aug. 22, 2019]

§ 240.15c3-1c Consolidated computations of net capital and aggregate indebtedness for certain subsidiaries and affiliates (appendix C to 17 CFR 240.15c3-1).

(a) *Flow through capital benefits.* Every broker or dealer in computing its net capital and aggregate indebtedness pursuant to 17 CFR 240.15c3-1 shall, subject to the provisions of paragraphs (b) and (d) of this appendix, consolidate in a single computation assets and liabilities of any subsidiary or affiliate for which it guarantees, endorses or assumes directly or indirectly the obligations or liabilities. The assets and liabilities of a subsidiary or affiliate whose liabilities and obligations have not been guaranteed, endorsed, or assumed directly or indirectly by the broker or dealer may also be so consolidated if an opinion of counsel is obtained as provided for in paragraph (b) of this section.

(b) *Required counsel opinions.* (1) If the consolidation, provided for in paragraph (a) of this section, of any such subsidiary or affiliate results in the increase of the broker's or dealers's net

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capital and/or the decrease of the broker's or dealer's minimum net capital requirement under paragraph (a) of § 240.15c3-1 and an opinion of counsel described in paragraph (b)(2) of this section has not been obtained, such benefits shall not be recognized in the broker's or dealer's computation required by this section.

(2) Except as provided for in paragraph (b)(1) of this section, consolidation shall be permitted with respect to any subsidiaries or affiliates which are majority owned and controlled by the broker or dealer for which the broker or dealer can demonstrate to the satisfaction of the Commission, through the Examining Authority, by an opinion of counsel that the net asset values, or the portion thereof related to the parent's ownership interest in the subsidiary or affiliate may be caused by the broker or dealer or a trustee appointed pursuant to the Securities Investor Protection Act of 1970 or otherwise, to be distributed to the broker or dealer within 30 calendar days. Such opinion shall also set forth the actions necessary to cause such a distribution to be made, identify the parties having the authority to take such actions, identify and describe the rights of other parties or classes of parties, including but not limited to customers, general creditors, subordinated lenders, minority shareholders, employees, litigants and governmental or regulatory authorities, who may delay or prevent such a distribution and such other assurances as the Commission or the Examining Authority by rule or interpretation may require. Such opinion shall be current and periodically renewed in connection with the broker's or dealer's annual audit pursuant to 17 CFR 240.17a-5 under the Securities Exchange Act of 1934 or upon any material change in circumstances.

(c) *Principles of consolidation.* In preparing a consolidated computation of net capital and/or aggregate indebtedness pursuant to this section, the following minimum and non-exclusive requirements shall be observed:

(1) Consolidated net worth shall be reduced by the estimated amount of any tax reasonably anticipated to be incurred upon distribution of the assets of the subsidiary or affiliate.

(2) Liabilities of a consolidated subsidiary or affiliate which are subordinated to the claims of present and future creditors pursuant to a satisfactory subordination agreement shall not be added to consolidated net worth unless such subordination extends also to the claims of present or future creditors of the parent broker or dealer and all consolidated subsidiaries.

(3) Subordinated liabilities of a consolidated subsidiary or affiliate which are consolidated in accordance with paragraph (c)(2) of this section may not be prepaid, repaid or accelerated if any of the entities included in such consolidation would otherwise be unable to comply with the provisions of Appendix (D), 17 CFR 240.15c3-1d.

(4) Each broker or dealer included within the consolidation shall at all times be in compliance with the net capital requirement to which it is subject.

(d) *Certain precluded acts.* No broker or dealer shall guarantee, endorse or assume directly or indirectly any obligation or liability of a subsidiary or affiliate unless the obligation or liability is reflected in the computation of net capital and/or aggregate indebtedness pursuant to 17 CFR 240.15c3-1 or this appendix (C), except as provided in paragraph (b)(1) of this section.

[40 FR 29808, July 16, 1975, as amended at 57 FR 56988, Dec. 2, 1992]

§ 240.15c3-1d Satisfactory Subordination Agreements (Appendix D to 17 CFR 240.15c3-1).

(a) *Introduction.* (1) This appendix sets forth minimum and non-exclusive requirements for satisfactory subordination agreements (hereinafter "subordination agreement"). The Examining Authority may require or the broker or dealer may include such other provisions as deemed necessary or appropriate to the extent such provisions do not cause the subordination agreement to fail to meet the minimum requirements of this Appendix (D).

(2) *Certain definitions.* For purposes of 17 CFR 240.15c3-1 and this Appendix (D):

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(i) A subordination agreement may be either a subordinated loan agreement or a secured demand note agreement.

(ii) The term *subordinated loan agreement* shall mean the agreement or agreements evidencing or governing a subordinated borrowing of cash.

(iii) The term *collateral value* of any securities pledged to secure a secured demand note shall mean the market value of such securities after giving effect to the percentage deductions set forth in paragraph (c)(2)(vi) of § 240.15c3-1 except for paragraph (c)(2)(vi)(J). In lieu of the deduction under (c)(2)(vi)(J), the broker or dealer shall reduce the market value of the securities pledged to secure the secured demand note by 30 percent.

(iv) The term *payment obligation* shall mean the obligation of a broker or dealer in respect to any subordination agreement (A) to repay cash loaned to the broker or dealer pursuant to a subordinated loan agreement or (B) to return a secured demand note contributed to the broker or dealer or reduce the unpaid principal amount thereof and to return cash or securities pledged as collateral to secure the secured demand note and (C) "Payment" shall mean the performance by a broker or dealer of a Payment Obligation.

(v)(A) The term *secured demand note agreement* shall mean an agreement (including the related secured demand note) evidencing or governing the contribution of a secured demand note to a broker or dealer and the pledge of securities and/or cash with the broker or dealer as collateral to secure payment of such secured demand note. The secured demand note agreement may provide that neither the lender, his heirs, executors, administrators or assigns shall be personally liable on such note and that in the event of default the broker or dealer shall look for payment of such note solely to the collateral then pledged to secure the same.

(B) The secured demand note shall be a promissory note executed by the lender and shall be payable on the demand of the broker or dealer to which it is contributed; provided, however, that the making of such demand may be conditioned upon the occurrence of any of certain events which are accept-

able to the Commission and to the Examining Authority for such broker or dealer.

(C) If such note is not paid upon presentment and demand as provided for therein, the broker or dealer shall have the right to liquidate all or any part of the securities then pledged as collateral to secure payment of the same and to apply the net proceeds of such liquidation, together with any cash then included in the collateral, in payment of such note. Subject to the prior rights of the broker or dealer as pledgee, the lender, as defined herein, may retain ownership of the collateral and have the benefit of any increases and bear the risks of any decreases in the value of the collateral and may retain the right to vote securities contained within the collateral and any right to income therefrom or distributions thereon, except the broker or dealer shall have the right to receive and hold as pledgee all dividends payable in securities and all partial and complete liquidating dividends.

(D) Subject to the prior rights of the broker or dealer as pledgee, the lender may have the right to direct the sale of any securities included in the collateral, to direct the purchases of securities with any cash included therein, to withdraw excess collateral or to substitute cash or other securities as collateral, provided that the net proceeds of any such sale and the cash so substituted and the securities so purchased or substituted are held by the broker or dealer, as pledgee, and are included within the collateral to secure payment of the secured demand note, and provided further that no such transaction shall be permitted if, after giving effect thereto, the sum of the amount of any cash, plus the Collateral Value of the securities, then pledged as collateral to secure the secured demand note would be less than the unpaid principal amount of the secured demand note.

(E) Upon payment by the lender, as distinguished from a reduction by the lender which is provided for in (b)(6)(iii) or reduction by the broker or dealer as provided for in subparagraph (b)(7) of this appendix (D), of all or any part of the unpaid principal amount of the secured demand note, a broker or

dealer shall issue to the lender a subordinated loan agreement in the amount of such payment (or in the case of a broker or dealer that is a partnership credit a capital account of the lender) or issue preferred or common stock of the broker or dealer in the amount of such payment, or any combination of the foregoing, as provided for in the secured demand note agreement.

(F) The term *lender* shall mean the person who lends cash to a broker or dealer pursuant to a subordinated loan agreement and the person who contributes a secured demand note to a broker or dealer pursuant to a secured demand note agreement.

(b) *Minimum requirements for subordination agreements.* (1) Subject to paragraph (a) of this section, a subordination agreement shall mean a written agreement between the broker or dealer and the lender, which (i) has a minimum term of one year, except for temporary subordination agreements provided for in paragraph (c)(5) of this appendix (D), and (ii) is a valid and binding obligation enforceable in accordance with its terms (subject as to enforcement to applicable bankruptcy, insolvency, reorganization, moratorium and other similar laws) against the broker or dealer and the lender and their respective heirs, executors, administrators, successors and assigns.

(2) *Specific amount.* All subordination agreements shall be for a specific dollar amount which shall not be reduced for the duration of the agreement except by installments as specifically provided for therein and except as otherwise provided in this appendix (D).

(3) *Effective subordination.* The subordination agreement shall effectively subordinate any right of the lender to receive any Payment with respect thereto, together with accrued interest or compensation, to the prior payment or provision for payment in full of all claims of all present and future creditors of the broker or dealer arising out of any matter occurring prior to the date on which the related Payment Obligation matures consistent with the provisions of 17 CFR 240.15c3-1 and 240.15c3-1d, except for claims which are the subject of subordination agreements which rank on the same priority

as or junior to the claim of the lender under such subordination agreements.

(4) *Proceeds of subordinated loan agreements.* The subordinated loan agreement shall provide that the cash proceeds thereof shall be used and dealt with by the broker or dealer as part of its capital and shall be subject to the risks of the business.

(5) *Certain rights of the broker or dealer.* The subordination agreement shall provide that the broker or dealer shall have the right to:

(i) Deposit any cash proceeds of a subordinated loan agreement and any cash pledged as collateral to secure a secured demand note in an account or accounts in its own name in any bank or trust company;

(ii) Pledge, repledge, hypothecate and rehypothecate, any or all of the securities pledged as collateral to secure a secured demand note, without notice, separately or in common with other securities or property for the purpose of securing any indebtedness of the broker or dealer; and

(iii) Lend to itself or others any or all of the securities and cash pledged as collateral to secure a secured demand note.

(6) *Collateral for secured demand notes.* Only cash and securities which are fully paid for and which may be publicly offered or sold without registration under the Securities Act of 1933, and the offer, sale and transfer of which are not otherwise restricted, may be pledged as collateral to secure a secured demand note. The secured demand note agreement shall provide that if at any time the sum of the amount of any cash, plus the Collateral Value of any securities, then pledged as collateral to secure the secured demand note is less than the unpaid principal amount of the secured demand note, the broker or dealer must immediately transmit written notice to that effect to the lender and the Examining Authority for such broker or dealer. The secured demand note agreement shall also require that following such transmittal:

(i) The lender, prior to noon of the business day next succeeding the transmittal of such notice, may pledge as collateral additional cash or securities sufficient, after giving effect to such

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pledge, to bring the sum of the amount of any cash plus the Collateral Value of any securities, then pledged as collateral to secure the secured demand note, up to an amount not less than the unpaid principal amount of the secured demand note; and

(ii) Unless additional cash or securities are pledged by the lender as provided in paragraph (b)(6)(i) of this section, the broker or dealer at noon on the business day next succeeding the transmittal of notice to the lender must commence sale, for the account of the lender, of such of the securities then pledged as collateral to secure the secured demand note and apply so much of the net proceeds thereof, together with such of the cash then pledged as collateral to secure the secured demand note as may be necessary to eliminate the unpaid principal amount of the secured demand note; *Provided, however,* That the unpaid principal amount of the secured demand note need not be reduced below the sum of the amount of any remaining cash, plus the Collateral Value of the remaining securities, then pledged as collateral to secure the secured demand note. The broker or dealer may not purchase for its own account any securities subject to such a sale.

(iii) The secured demand note agreement also may provide that, in lieu of the procedures specified in the provisions required by paragraph (b)(6)(ii) of this section, the lender with the prior written consent of the broker or dealer and the Examining Authority for the broker or dealer may reduce the unpaid principal amount of the secured demand note. After giving effect to such reduction, the aggregate indebtedness of the broker or dealer may not exceed 1000 percent of its net capital or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3-1, net capital may not be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3-3a, or, if registered as a futures commission merchant, 7 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers subject to the rules of a contract mar-

ket, each such deduction not to exceed the amount of funds in the option customer's account), if greater. No single secured demand note shall be permitted to be reduced by more than 15 percent of its original principal amount and after such reduction no excess collateral may be withdrawn. No Examining Authority shall consent to a reduction of the principal amount of a secured demand note if, after giving effect to such reduction, net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3-1.

Permissive Prepayments

(7) A broker or dealer at its option but not at the option of the lender may, if the subordination agreement so provides, make a Payment of all or any portion of the Payment Obligation thereunder prior to the scheduled maturity date of such Payment Obligation (hereinafter referred to as a "Prepayment"), but in no event may any Prepayment be made before the expiration of one year from the date such subordination agreement became effective. This restriction shall not apply to temporary subordination agreements that comply with the provisions of paragraph (c)(5) of this section. No Prepayment shall be made, if, after giving effect thereto (and to all Payments of Payment Obligations under any other subordinated agreements then outstanding the maturity or accelerated maturities of which are scheduled to fall due within six months after the date such Prepayment is to occur pursuant to this provision or on or prior to the date on which the Payment Obligation in respect of such Prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the broker or dealer, either aggregate indebtedness of the broker or dealer would exceed 1000 percent of its net capital or its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3-1 or, in the case of a broker or dealer operating pursuant to § 240.15c3-1(a)(1)(ii), its net capital would be less than 5 percent of its aggregate debit items computed in accordance with

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§ 240.15c3-3a, or if registered as a futures commission merchant, 7 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3-1(a)(1)(ii), or if, in the case of a broker or dealer operating pursuant to § 240.15c3-1(a)(10), its net capital would be less than 120 percent of its minimum requirement.

Suspended Repayment

(8)(i) The Payment Obligation of the broker or dealer in respect of any subordination agreement shall be suspended and shall not mature if, after giving effect to Payment of such Payment Obligation (and to all Payments of Payment Obligations of such broker or dealer under any other subordination agreement(s) then outstanding that are scheduled to mature on or before such Payment Obligation) either:

(A) The aggregate indebtedness of the broker or dealer would exceed 1200 percent of its net capital, or in the case of a broker or dealer operating pursuant to § 240.15c3-1(a)(1)(ii), its net capital would be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3-3a or, if registered as a futures commission merchant, 6 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or, in the case of a broker or dealer operating pursuant to § 240.15c3-1(a)(10), its net capital would be less than 120 percent of its minimum requirement; or

(B) Its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3-1 including paragraph (a)(1)(ii), if applicable. The subordination agreement may pro-

vide that if the Payment Obligation of the broker or dealer thereunder does not mature and is suspended as a result of the requirement of this paragraph (b)(8) for a period of not less than six months, the broker or dealer shall thereupon commence the rapid and orderly liquidation of its business, but the right of the lender to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of §§ 240.15c3-1 and 240.15c3-1d.

(ii) [Reserved]

(9) *Accelerated maturity-obligation to repay to remain subordinate.* (i) Subject to the provisions of paragraph (b)(8) of this appendix, a subordination agreement may provide that the lender may, upon prior written notice to the broker or dealer and the Examining Authority given not earlier than six months after the effective date of such subordination agreement, accelerate the date on which the Payment Obligation of the broker or dealer, together with accrued interest or compensation, is scheduled to mature to a date not earlier than six months after the giving of such notice, but the right of the lender to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of 17 CFR 240.15c3-1 and 240.15c3-1d.

(ii) Notwithstanding the provisions of paragraph (b)(8) of this appendix, the Payment Obligation of the broker or dealer with respect to a subordination agreement, together with accrued interest and compensation, shall mature in the event of any receivership, insolvency, liquidation pursuant to the Securities Investor Protection Act of 1970 or otherwise, bankruptcy, assignment for the benefit of creditors, reorganization whether or not pursuant to the bankruptcy laws, or any other marshalling of the assets and liabilities of the broker or dealer but the right of the lender to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of 17 CFR 240.15c3-1 and 240.15c3-1d.

(10)(i) *Accelerated maturity of subordination agreements on event of default and event of acceleration—obligation to repay to remain subordinate.* A subordination agreement may provide that the lender

may, upon prior written notice to the broker or dealer and the Examining Authority of the broker or dealer of the occurrence of any Event of Acceleration (as hereinafter defined) given no sooner than six months after the effective date of such subordination agreement, accelerate the date on which the Payment Obligation of the broker or dealer, together with accrued interest or compensation, is scheduled to mature, to the last business day of a calendar month which is not less than six months after notice of acceleration is received by the broker or dealer and the Examining Authority for the broker or dealer. Any subordination agreement containing such Events of Acceleration may also provide, that if upon such accelerated maturity date the Payment Obligation of the broker or dealer is suspended as required by paragraph (b)(8) of this appendix (D) and liquidation of the broker or dealer has not commenced on or prior to such accelerated maturity date, then notwithstanding paragraph (b)(8) of this appendix the Payment Obligation of the broker or dealer with respect to such subordination agreement shall mature on the day immediately following such accelerated maturity date and in any such event the Payment Obligations of the broker or dealer with respect to all other subordination agreements then outstanding shall also mature at the same time but the rights of the respective lenders to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of this Appendix (D). Events of Acceleration which may be included in a subordination agreement complying with this paragraph (b)(10) shall be limited to:

(A) Failure to pay interest or any installment of principal on a subordination agreement as scheduled;

(B) Failure to pay when due other money obligations of a specified material amount;

(C) Discovery that any material, specified representation or warranty of the broker or dealer which is included in the subordination agreement and on which the subordination agreement was based or continued was inaccurate in a material respect at the time made;

(D) Any specified and clearly measurable event which is included in the subordination agreement and which the lender and the broker or dealer agree (1) is a significant indication that the financial position of the broker or dealer has changed materially and adversely from agreed upon specified norms or (2) could materially and adversely affect the ability of the broker or dealer to conduct its business as conducted on the date the subordination agreement was made; or (3) is a significant change in the senior management of the broker or dealer or in the general business conducted by the broker or dealer from that which obtained on the date the subordination agreement became effective;

(E) Any continued failure to perform agreed covenants included in the subordination agreement relating to the conduct of the business of the broker or dealer or relating to the maintenance and reporting of its financial position; and

(ii) Notwithstanding the provisions of paragraph (b)(8) of this appendix, a subordination agreement may provide that, if liquidation of the business of the broker or dealer has not already commenced, the Payment Obligation of the broker or dealer shall mature, together with accrued interest or compensation, upon the occurrence of an Event of Default (as hereinafter defined). Such agreement may also provide that, if liquidation of the business of the broker or dealer has not already commenced, the rapid and orderly liquidation of the business of the broker or dealer shall then commence upon the happening of an Event of Default. Any subordination agreement which so provides for maturity of the Payment Obligation upon the occurrence of an Event of Default shall also provide that the date on which such Event of Default occurs shall, if liquidation of the broker or dealer has not already commenced, be the date on which the Payment Obligations of the broker or dealer with respect to all other subordination agreements then outstanding shall mature but the rights of the respective lenders to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of this Appendix (D).

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Events of Default which may be included in a subordination agreement shall be limited to:

(A) The making of an application by the Securities Investor Protection Corporation for a decree adjudicating that customers of the broker or dealer are in need of protection under the Securities Investor Protection Act of 1970 and the failure of the broker or dealer to obtain the dismissal of such application within 30 days;

(B) The aggregate indebtedness of the broker or dealer exceeding 1500 percent of its net capital or, in the case of a broker or dealer that has elected to operate under §240.15c3-1(a)(1)(ii), its net capital computed in accordance therewith is less than two percent of its aggregate debit items computed in accordance with §240.15c3-3a or, if registered as a futures commission merchant, four percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or, in the case of a broker or dealer operating pursuant to §240.15c3-1(a)(10), its net capital is less than its minimum requirement, throughout a period of 15 consecutive business days, commencing on the day the broker or dealer first determines and notifies the Examining Authority for the broker or dealer, or the Examining Authority or the Commission first determines and notifies the broker or dealer of such fact;

(C) The Commission shall revoke the registration of the broker or dealer;

(D) The Examining Authority shall suspend (and not reinstate within 10 days) or revoke the broker's or dealer's status as a member thereof;

(E) Any receivership, insolvency, liquidation pursuant to the Securities Investor Protection Act of 1970 or otherwise, bankruptcy, assignment for the benefit of creditors, reorganization whether or not pursuant to bankruptcy laws, or any other marshalling of the assets and liabilities of the broker or dealer.

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A subordination agreement which contains any of the provisions permitted by this paragraph (b)(10) shall not contain the provision otherwise permitted by clause (i) of paragraph (b)(9).

BROKERS AND DEALERS CARRYING THE ACCOUNTS OF SPECIALISTS AND MARKET MAKERS IN LISTED OPTIONS

(11) A subordination agreement which becomes effective on or after August 1, 1977 in favor of a broker or dealer who guarantees, endorses, carries or clears specialist or market maker transactions in options listed on a national securities exchange or facility of a national securities association shall provide that reduction, prepayment or repayment of the unpaid principal amount thereof, pursuant to those terms of the agreement required or permitted by paragraphs (b)(6)(iii), (b)(7), or (b)(8)(i) of this section, shall not occur in contravention of paragraphs (a)(6)(v), (a)(7)(iv), or (c)(2)(x)(B)(1) of §240.15c3-1 insofar as they apply to such broker or dealer.

(c) *Miscellaneous Provisions*—(1) *Prohibited Cancellation*. The subordination agreement shall not be subject to cancellation by either party; no Payment shall be made with respect thereto and the agreement shall not be terminated, rescinded or modified by mutual consent or otherwise if the effect thereof would be inconsistent with the requirements of 17 CFR 240.15c3-1 and 240.15c3-1d.

(2) Every broker or dealer shall immediately notify the Examining Authority for such broker or dealer if, after giving effect to all Payments of Payment Obligations under subordination agreements then outstanding that are then due or mature within the following six months without reference to any projected profit or loss of the broker or dealer either the aggregate indebtedness of the broker or dealer would exceed 1200 percent of its net capital or its net capital would be less than 120 percent of the minimum dollar amount required by §240.15c3-1, or, in the case of a broker or dealer operating pursuant to §240.15c3-1(a)(1)(ii), its net capital would be less than 5 percent of

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aggregate debit items computed in accordance with § 240.15c3-3a, or, if registered as a futures commission merchant, 6 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or less than 120 percent of the minimum dollar amount required by § 240.15c3-1(a)(1)(ii), or, in the case of a broker or dealer operating pursuant to § 240.15c3-1(a)(10), its net capital would be less than 120 percent of its minimum requirement.

(3) *Certain legends.* If all the provisions of a satisfactory subordination agreement do not appear in a single instrument, then the debenture or other evidence of indebtedness shall bear on its face an appropriate legend stating that it is issued subject to the provisions of a satisfactory subordination agreement which shall be adequately referred to and incorporated by reference.

(4) *Legal title to securities.* All securities pledged as collateral to secure a secured demand note must be in bearer form, or registered in the name of the broker or dealer or the name of its nominee or custodian.

Temporary and Revolving Subordination Agreements

(5)(i) For the purpose of enabling a broker or dealer to participate as an underwriter of securities or other extraordinary activities in compliance with the net capital requirements of § 240.15c3-1, a broker or dealer shall be permitted, on no more than three occasions in any 12 month period, to enter into a subordination agreement on a temporary basis that has a stated term of no more than 45 days from the date such subordination agreement became effective. This temporary relief shall not apply to a broker or dealer if, within the preceding thirty calendar days, it has given notice pursuant to § 240.17a-11, or if immediately prior to entering into such subordination agreement, either:

(A) The aggregate indebtedness of the broker or dealer exceeds 1000 percent of its net capital or its net capital is less than 120 percent of the minimum dollar amount required by § 240.15c3-1, or

(B) In the case of a broker or dealer operating pursuant to § 240.15c3-1(a)(1)(ii), its net capital is less than 5 percent of aggregate debits computed in accordance with § 240.15c3-1, or, if registered as a futures commission merchant, less than 7 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of this section, or, in the case of a broker or dealer operating pursuant to § 240.15c3-1(a)(10), its net capital would be less than 120 percent of its minimum requirement, or

(C) The amount of its then outstanding subordination agreements exceeds the limits specified in paragraph (d) of § 240.15c3-1. Such temporary subordination agreement shall be subject to all other provisions of this appendix D.

(ii) A broker or dealer shall be permitted to enter into a revolving subordinated loan agreement which provides for prepayment within less than one year of all or any portion of the Payment Obligation thereunder at the option of the broker or dealer upon the prior written approval of the Examining Authority for the broker or dealer. The Examining Authority, however, shall not approve any prepayment if:

(A) After giving effect thereto (and to all Payments of Payment Obligations under any other subordinated agreements then outstanding, the maturity or accelerated maturities of which are scheduled to fall due within six months after the date such prepayment is to occur pursuant to this provision or on or prior to the date on which the Payment Obligation in respect of such prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to

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any projected profit or loss of the broker or dealer, either aggregate indebtedness of the broker or dealer would exceed 900 percent of its net capital or its net capital would be less than 200 percent of the minimum dollar amount required by § 240.15c3-1 or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3-1, its net capital would be less than 6 percent of aggregate debit items computed in accordance with § 240.15c3-3a, or, if registered as a futures commission merchant, 10 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or its net capital would be less than 200 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of this section or

(B) Pre-tax losses during the latest three-month period equalled more than 15% of current excess net capital.

Any subordination agreement entered into pursuant to this paragraph (c)(5)(ii) shall be subject to all the other provisions of this Appendix D. Any such subordination agreement shall not be considered equity for purposes of subsection (d) of section 15c3-1, despite the length of the initial term of the loan.

(6)(i) *Filing.* Two copies of any proposed subordination agreement (including nonconforming subordination agreements) shall be filed at least 10 days prior to the proposed execution date of the agreement with the Commission's Regional Office for the region in which the broker or dealer maintains its principal place of business or at such other time as the Regional Office for good cause shall accept such filing. Copies of the proposed agreement shall also be filed with the Examining Authority in such quantities and at such time as the Examining Authority may require. The broker or dealer shall also file with said parties a statement setting forth the name and address of the lender, the business rela-

tionship of the lender to the broker or dealer, and whether the broker or dealer carried funds or securities for the lender at or about the time the proposed agreement was so filed. All agreements shall be examined by the Commission's Regional Office or the Examining Authority with whom such agreement is required to be filed prior to their becoming effective. No proposed agreement shall be a satisfactory subordination agreement for the purposes of this section unless and until the Examining Authority has found the agreement acceptable and such agreement has become effective in the form found acceptable.

(ii) The broker or dealer need not file with the Regional Office for the region in which the broker or dealer maintains its principal place of business (if a Regional Office is not its Examining Authority) copies of any proposed subordination agreement or the statement described above if the Examining Authority for that broker or dealer has consented to file with the Commission periodic reports (not less than monthly) summarizing for the period, on a firm-by-firm basis, the subordination agreements it has approved for that period. Such reports should include at the minimum, the amount of the loan and its duration, the name of the lender and the business relationship of the lender to the broker or dealer.

(7) *Subordination agreements in effect prior to adoption.* Any subordination agreement which has been entered into prior to December 20, 1978 and which has been deemed to be satisfactorily subordinated pursuant to 17 CFR 240.15c3-1 as in effect prior to December 20, 1978, shall continue to be deemed a satisfactory subordination agreement until the maturity of such agreement. *Provided,* That no renewal of an agreement which provides for automatic or optional renewal by the broker or dealer or lender shall be deemed to be a satisfactory subordination agreement unless such renewed agreement meets the requirements of this appendix within 6 months from December 20, 1978.

Provided, further, That all subordination agreements must meet the requirements of this appendix within 5 years of December 20, 1978.

[40 FR 29808, July 16, 1975, as amended at 42 FR 31778, June 23, 1977; 44 FR 34887, June 15, 1979; 46 FR 35635, July 10, 1981; 47 FR 21775, May 20, 1982; 49 FR 31848, Aug. 9, 1984; 57 FR 56988, Dec. 2, 1992; 58 FR 37657, July 13, 1993; 59 FR 5945, Feb. 9, 1994; 73 FR 32228, June 5, 2008; 84 FR 44045, Aug. 22, 2019]

§ 240.15c3-1e Deductions for market and credit risk for certain brokers or dealers (Appendix E to 17 CFR 240.15c3-1).

Sections 240.15c3-1e and 240.15c3-1g set forth a program that allows a broker or dealer to use an alternative approach to computing net capital deductions, subject to the conditions described in §§ 240.15c3-1e and 240.15c3-1g, including supervision of the broker's or dealer's ultimate holding company under the program. The program is designed to reduce the likelihood that financial and operational weakness in the holding company will destabilize the broker or dealer, or the broader financial system. The focus of this supervision of the ultimate holding company is its financial and operational condition and its risk management controls and methodologies.

Application

(a) A broker or dealer may apply to the Commission for authorization to compute deductions for market risk pursuant to this section in lieu of computing deductions pursuant to §§ 240.15c3-1(c)(2)(vi) and (vii) and 240.15c3-1b, and to compute deductions for credit risk pursuant to this section on credit exposures arising from transactions in derivatives instruments (if this section is used to calculate deductions for market risk on these instruments) in lieu of computing deductions pursuant to § 240.15c3-1(c)(2)(iv) and (c)(2)(xv)(A) and (B):

(1) A broker-dealer shall submit the following information to the Commission with its application:

(i) An executive summary of the information provided to the Commission with its application and an identification of the ultimate holding company of the broker or dealer;

(ii) A comprehensive description of the internal risk management control system of the broker or dealer and how that system satisfies the requirements set forth in § 240.15c3-4;

(iii) A list of the categories of positions that the broker or dealer holds in its proprietary accounts and a brief description of the methods that the broker or dealer will use to calculate deductions for market and credit risk on those categories of positions;

(iv) A description of the mathematical models to be used to price positions and to compute deductions for market risk, including those portions of the deductions attributable to specific risk, if applicable, and deductions for credit risk; a description of the creation, use, and maintenance of the mathematical models; a description of the broker's or dealer's internal risk management controls over those models, including a description of each category of persons who may input data into the models; if a mathematical model incorporates empirical correlations across risk categories, a description of the process for measuring correlations; a description of the backtesting procedures the broker or dealer will use to backtest the mathematical model used to calculate maximum potential exposure; a description of how each mathematical model satisfies the applicable qualitative and quantitative requirements set forth in paragraph (d) of this appendix E; and a statement describing the extent to which each mathematical model used to compute deductions for market and credit risk will be used as part of the risk analyses and reports presented to senior management;

(v) If the broker or dealer is applying to the Commission for approval to use scenario analysis to calculate deductions for market risk for certain positions, a list of those types of positions, a description of how those deductions will be calculated using scenario analysis, and an explanation of why each scenario analysis is appropriate to calculate deductions for market risk on those types of positions;

(vi) A description of how the broker or dealer will calculate current exposure;

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(vii) A description of how the broker or dealer will determine internal credit ratings of counterparties and internal credit risk weights of counterparties, if applicable;

(viii) A written undertaking by the ultimate holding company of the broker or dealer, if it is not an ultimate holding company that has a principal regulator, in a form acceptable to the Commission, signed by a duly authorized person at the ultimate holding company, to the effect that, as a condition of Commission approval of the application of the broker or dealer to compute deductions for market and credit risk pursuant to this appendix E, the ultimate holding company agrees to:

(A) Comply with all applicable provisions of this appendix E;

(B) Comply with all applicable provisions of § 240.15c3-1g;

(C) Comply with the provisions of § 240.15c3-4 with respect to an internal risk management control system for the affiliate group as though it were an OTC derivatives dealer with respect to all of its business activities, except that paragraphs (c)(5)(xiii), (c)(5)(xiv), (d)(8), and (d)(9) of § 240.15c3-4 shall not apply;

(D) As part of the internal risk management control system for the affiliate group, establish, document, and maintain procedures for the detection and prevention of money laundering and terrorist financing;

(E) Permit the Commission to examine the books and records of the ultimate holding company and any of its affiliates, if the affiliate is not an entity that has a principal regulator;

(F) If the disclosure to the Commission of any information required as a condition for the broker or dealer to compute deductions for market and credit risk pursuant to this appendix E could be prohibited by law or otherwise, cooperate with the Commission, to the extent permissible, including by describing any secrecy laws or other impediments that could restrict the ability of material affiliates to provide information on their operations or activities and by discussing the manner in which the ultimate holding company and the broker or dealer propose to provide the Commission with adequate

information or assurances of access to information;

(G) Make available to the Commission information about the ultimate holding company or any of its material affiliates that the Commission finds is necessary to evaluate the financial and operational risk within the ultimate holding company and its material affiliates and to evaluate compliance with the conditions of eligibility of the broker or dealer to compute deductions to net capital under the alternative method of this appendix E;

(H) Make available examination reports of principal regulators for those affiliates of the ultimate holding company that are not subject to Commission examination; and

(I) Acknowledge that, if the ultimate holding company fails to comply in a material manner with any provision of its undertaking, the Commission may, in addition to any other conditions necessary or appropriate in the public interest or for the protection of investors, increase the multiplication factors the ultimate holding company uses to calculate allowances for market and credit risk, as defined in § 240.15c3-1g(a)(2) and (a)(3) or impose any condition with respect to the broker or dealer listed in paragraph (e) of this appendix E; and

(ix) A written undertaking by the ultimate holding company of the broker or dealer, if the ultimate holding company has a principal regulator, in a form acceptable to the Commission, signed by a duly authorized person at the ultimate holding company, to the effect that, as a condition of Commission approval of the application of the broker or dealer to compute deductions for market and credit risk pursuant to this appendix E, the ultimate holding company agrees to:

(A) Comply with all applicable provisions of this appendix E;

(B) Comply with all applicable provisions of § 240.15c3-1g;

(C) Make available to the Commission information about the ultimate holding company that the Commission finds is necessary to evaluate the financial and operational risk within the ultimate holding company and to evaluate compliance with the conditions of eligibility of the broker or

dealer to compute net capital under the alternative method of this appendix E; and

(D) Acknowledge that if the ultimate holding company fails to comply in a material manner with any provision of its undertaking, the Commission may, in addition to any other conditions necessary or appropriate in the public interest or for the protection of investors, impose any condition with respect to the broker or dealer listed in paragraph (e) of this appendix E;

(2) As a condition of Commission approval, the ultimate holding company of the broker or dealer, if it is not an ultimate holding company that has a principal regulator, shall include the following information with the application:

(i) A narrative description of the business and organization of the ultimate holding company;

(ii) An alphabetical list of the affiliates of the ultimate holding company (referred to as the "affiliate group," which shall include the ultimate holding company), with an identification of the financial regulator, if any, that regulates the affiliate, and a designation of the members of the affiliate group that are material to the ultimate holding company ("material affiliates");

(iii) An organizational chart that identifies the ultimate holding company, the broker or dealer, and the material affiliates;

(iv) Consolidated and consolidating financial statements of the ultimate holding company as of the end of the quarter preceding the filing of the application;

(v) Sample computations for the ultimate holding company of allowable capital and allowances for market risk, credit risk, and operational risk, determined pursuant to § 240.15c3-1g(a)(1)-(a)(4);

(vi) A list of the categories of positions that the affiliate group holds in its proprietary accounts and a brief description of the method that the ultimate holding company proposes to use to calculate allowances for market and credit risk, pursuant to § 240.15c3-1g(a)(2) and (a)(3), on those categories of positions;

(vii) A description of the mathematical models to be used to price positions and to compute the allowance for market risk, including those portions of the allowance attributable to specific risk, if applicable, and the allowance for credit risk; a description of the creation, use, and maintenance of the mathematical models; a description of the ultimate holding company's internal risk management controls over those models, including a description of each category of persons who may input data into the models; if a mathematical model incorporates empirical correlations across risk categories, a description of the process for measuring correlations; a description of the backtesting procedures the ultimate holding company will use to backtest the mathematical model used to calculate maximum potential exposure; a description of how each mathematical model satisfies the applicable qualitative and quantitative requirements set forth in paragraph (d) of this appendix E; a statement describing the extent to which each mathematical model used to compute allowances for market and credit risk is used as part of the risk analyses and reports presented to senior management; and a description of any positions for which the ultimate holding company proposes to use a method other than VaR to compute an allowance for market risk and a description of how that allowance would be determined;

(viii) A description of how the ultimate holding company will calculate current exposure;

(ix) A description of how the ultimate holding company will determine the credit risk weights of counterparties and internal credit ratings of counterparties, if applicable;

(x) A description of how the ultimate holding company will calculate an allowance for operational risk under § 240.15c3-1g(a)(4);

(xi) For each instance in which a mathematical model used by the broker or dealer to calculate a deduction for market risk or to calculate maximum potential exposure for a particular product or counterparty differs from the mathematical model used by the ultimate holding company to calculate an allowance for market risk or

to calculate maximum potential exposure for that same product or counterparty, a description of the difference(s) between the mathematical models;

(xii) A comprehensive description of the risk management control system for the affiliate group that the ultimate holding company has established to manage affiliate group-wide risk, including market, credit, liquidity and funding, legal and compliance, and operational risks, and how that system satisfies the requirements of § 240.15c3-4; and

(xiii) Sample risk reports that are provided to the persons at the ultimate holding company who are responsible for managing group-wide risk and that will be provided to the Commission pursuant to § 240.15c3-1g(b)(1)(i)(H);

(3) As a condition of Commission approval, the ultimate holding company of the broker or dealer, if the ultimate holding company has a principal regulator, shall include the following information with the broker's or dealer's application:

(i) A narrative description of the business and organization of the ultimate holding company;

(ii) An alphabetical list of the affiliates of the ultimate holding company (referred to as the "affiliate group," which shall include the ultimate holding company), with an identification of the financial regulator, if any, that regulates the affiliate, and a designation of those affiliates that are material to the ultimate holding company ("material affiliates");

(iii) An organizational chart that identifies the ultimate holding company, the broker or dealer, and the material affiliates;

(iv) Consolidated and consolidating financial statements of the ultimate holding company as of the end of the quarter preceding the filing of the application;

(v) The most recent capital measurements of the ultimate holding company, as reported to its principal regulator, calculated in accordance with the standards published by the Basel Committee on Banking Supervision, as amended from time to time;

(vi) For each instance in which a mathematical model to be used by the

broker or dealer to calculate a deduction for market risk or to calculate maximum potential exposure for a particular product or counterparty differs from the mathematical model used by the ultimate holding company to calculate an allowance for market risk or to calculate maximum potential exposure for that same product or counterparty, a description of the difference(s) between the mathematical models; and

(vii) Sample risk reports that are provided to the persons at the ultimate holding company who are responsible for managing group-wide risk and that will be provided to the Commission under § 240.15c3-1g(b)(1)(i)(H);

(4) The application of the broker or dealer shall be supplemented by other information relating to the internal risk management control system, mathematical models, and financial position of the broker or dealer or the ultimate holding company of the broker or dealer that the Commission may request to complete its review of the application;

(5) The application shall be considered filed when received at the Commission's principal office in Washington, DC. A person who files an application pursuant to this section for which it seeks confidential treatment may clearly mark each page or segregable portion of each page with the words "Confidential Treatment Requested." All information submitted in connection with the application will be accorded confidential treatment, to the extent permitted by law;

(6) If any of the information filed with the Commission as part of the application of the broker or dealer is found to be or becomes inaccurate before the Commission approves the application, the broker or dealer must notify the Commission promptly and provide the Commission with a description of the circumstances in which the information was found to be or has become inaccurate along with updated, accurate information;

(7)(i) The Commission may approve the application or an amendment to the application, in whole or in part, subject to any conditions or limitations the Commission may require, if the Commission finds the approval to

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be necessary or appropriate in the public interest or for the protection of investors, after determining, among other things, whether the broker or dealer has met the requirements of this appendix E and is in compliance with other applicable rules promulgated under the Act and by self-regulatory organizations, and whether the ultimate holding company of the broker or dealer is in compliance with the terms of its undertakings, as provided to the Commission;

(ii) The Commission may approve the temporary use of a provisional model in whole or in part, subject to any conditions or limitations the Commission may require, if:

(A) The broker or dealer has a complete application pending under this section;

(B) The use of the provisional model has been approved by:

(1) A prudential regulator;

(2) The Commodity Futures Trading Commission or a futures association registered with the Commodity Futures Trading Commission under section 17 of the Commodity Exchange Act;

(3) A foreign financial regulatory authority that administers a foreign financial regulatory system with capital requirements that the Commission has found are eligible for substituted compliance under § 240.3a71-6 if the provisional model is used for the purposes of calculating net capital;

(4) A foreign financial regulatory authority that administers a foreign financial regulatory system with margin requirements that the Commission has found are eligible for substituted compliance under § 240.3a71-6 if the provisional model is used for the purposes of calculating initial margin pursuant to § 240.18a-3; or

(5) Any other foreign supervisory authority that the Commission finds has approved and monitored the use of the provisional model through a process comparable to the process set forth in this section.

(8) A broker or dealer shall amend its application to calculate certain deductions for market and credit risk under this appendix E and submit the amendment to the Commission for approval before it may change materially a

mathematical model used to calculate market or credit risk or before it may change materially its internal risk management control system;

(9) As a condition to the broker's or dealer's calculation of deductions for market and credit risk under this appendix E, an ultimate holding company that does not have a principal regulator shall submit to the Commission, as an amendment to the broker's or dealer's application, any material changes to a mathematical model or other methods used to calculate allowances for market, credit, and operational risk, and any material changes to the internal risk management control system for the affiliate group. The ultimate holding company must submit these material changes to the Commission before making them;

(10) As a condition for the broker or dealer to compute deductions for market and credit risk under this appendix E, the broker or dealer agrees that:

(i) It will notify the Commission 45 days before it ceases to compute deductions for market and credit risk under this appendix E; and

(ii) The Commission may determine by order that the notice will become effective after a shorter or longer period of time if the broker or dealer consents or if the Commission determines that a shorter or longer period of time is necessary or appropriate in the public interest or for the protection of investors; and

(11) Notwithstanding paragraph (a)(10) of this section, the Commission, by order, may revoke a broker's or dealer's exemption that allows it to use the market risk standards of this appendix E to calculate deductions for market risk, instead of the provisions of § 240.15c3-1(c)(2)(vi) and (c)(2)(vii), and the exemption to use the credit risk standards of this appendix E to calculate deductions for credit risk on certain credit exposures arising from transactions in derivatives instruments, instead of the provisions of § 240.15c3-1(c)(2)(iv), if the Commission finds that such exemption is no longer necessary or appropriate in the public interest or for the protection of investors. In making its finding, the Commission will consider the compliance history of the broker or dealer related

to its use of models, the financial and operational strength of the broker or dealer and its ultimate holding company, the broker's or dealer's compliance with its internal risk management controls, and the ultimate holding company's compliance with its undertakings.

Market Risk

(b) A broker or dealer whose application, including amendments, has been approved under paragraph (a) of this appendix E shall compute a deduction for market risk in an amount equal to the sum of the following:

(1) For positions for which the Commission has approved the broker's or dealer's use of value-at risk ("VaR") models, the VaR of the positions multiplied by the appropriate multiplication factor determined according to paragraph (d)(1)(iii) of this appendix E, except that the initial multiplication factor shall be three, unless the Commission determines, based on a review of the broker's or dealer's application or an amendment to the application under paragraph (a) of this appendix E, including a review of its internal risk management control system and practices and VaR models, that another multiplication factor is appropriate;

(2) For positions for which the VaR model does not incorporate specific risk, a deduction for specific risk to be determined by the Commission based on a review of the broker's or dealer's application or an amendment to the application under paragraph (a) of this appendix E and the positions involved;

(3) For positions for which the Commission has approved the broker's or dealer's application to use scenario analysis, the greatest loss resulting from a range of adverse movements in relevant risk factors, prices, or spreads designed to represent a negative movement greater than, or equal to, the worst ten-day movement over the four years preceding calculation of the greatest loss, or some multiple of the greatest loss based on the liquidity of the positions subject to scenario analysis. If historical data is insufficient, the deduction shall be the largest loss within a three standard deviation movement in those risk factors, prices, or spreads over a ten-day period, multi-

plied by an appropriate liquidity adjustment factor. Irrespective of the deduction otherwise indicated under scenario analysis, the resulting deduction for market risk must be at least \$25 per 100 share equivalent contract for equity positions, or one-half of one percent of the face value of the contract for all other types of contracts, even if the scenario analysis indicates a lower amount. A qualifying scenario must include the following:

(i) A set of pricing equations for the positions based on, for example, arbitrage relations, statistical analysis, historic relationships, merger evaluation, or fundamental valuation of an offering of securities;

(ii) Auxiliary relationships mapping risk factors to prices; and

(iii) Data demonstrating the effectiveness of the scenario in capturing market risk, including specific risk; and

(4) For all remaining positions, the deductions specified in §§ 240.15c3-1(c)(2)(vi), (c)(2)(vii), and applicable appendices to § 240.15c3-1.

Credit Risk

(c) A broker or dealer whose application, including amendments, has been approved under paragraph (a) of this appendix E shall compute a deduction for credit risk on transactions in derivative instruments (if this appendix E is used to calculate a deduction for market risk on those instruments) in an amount equal to the sum of the following:

(1) A counterparty exposure charge in an amount equal to the sum of the following:

(i) The net replacement value in the account of each counterparty that is insolvent, or in bankruptcy, or that has senior unsecured long-term debt in default; and

(ii) For a counterparty not otherwise described in paragraph (c)(1)(i) of this appendix E, the credit equivalent amount of the broker's or dealer's exposure to the counterparty, as defined in paragraph (c)(4)(i) of this appendix E, multiplied by the credit risk weight of the counterparty, as defined in paragraph (c)(4)(vi) of this appendix E, multiplied by 8%;

(2) A concentration charge by counterparty in an amount equal to the sum of the following:

(i) For each counterparty with a credit risk weight of 20% or less, 5% of the amount of the current exposure to the counterparty in excess of 5% of the tentative net capital of the broker or dealer;

(ii) For each counterparty with a credit risk weight of greater than 20% but less than 50%, 20% of the amount of the current exposure to the counterparty in excess of 5% of the tentative net capital of the broker or dealer; and

(iii) For each counterparty with a credit risk weight of greater than 50%, 50% of the amount of the current exposure to the counterparty in excess of 5% of the tentative net capital of the broker or dealer; and

(3) A portfolio concentration charge of 100 percent of the amount of the broker's or dealer's aggregate current exposure for all counterparties in excess of 10 percent of the tentative net capital of the broker or dealer;

(4) *Terms.* (i) The *credit equivalent amount* of the broker's or dealer's exposure to a counterparty is the sum of the broker's or dealer's maximum potential exposure to the counterparty, as defined in paragraph (c)(4)(ii) of this appendix E, multiplied by the appropriate multiplication factor, and the broker's or dealer's current exposure to the counterparty, as defined in paragraph (c)(4)(iii) of this appendix E. The broker or dealer must use the multiplication factor determined according to paragraph (d)(1)(v) of this appendix E, except that the initial multiplication factor shall be one, unless the Commission determines, based on a review of the broker's or dealer's application or an amendment to the application approved under paragraph (a) of this appendix E, including a review of its internal risk management control system and practices and VaR models, that another multiplication factor is appropriate;

(ii) The *maximum potential exposure* is the VaR of the counterparty's positions with the broker or dealer, after applying netting agreements with the counterparty meeting the requirements of paragraph (c)(4)(iv) of this ap-

pendix E, taking into account the value of collateral from the counterparty held by the broker or dealer in accordance with paragraph (c)(4)(v) of this appendix E, and taking into account the current replacement value of the counterparty's positions with the broker or dealer;

(iii) The *current exposure* of the broker or dealer to a counterparty is the current replacement value of the counterparty's positions with the broker or dealer, after applying netting agreements with the counterparty meeting the requirements of paragraph (c)(4)(iv) of this appendix E and taking into account the value of collateral from the counterparty held by the broker or dealer in accordance with paragraph (c)(4)(v) of this appendix E;

(iv) *Netting agreements.* A broker or dealer may include the effect of a netting agreement that allows the broker or dealer to net gross receivables from and gross payables to a counterparty upon default of the counterparty if:

(A) The netting agreement is legally enforceable in each relevant jurisdiction, including in insolvency proceedings;

(B) The gross receivables and gross payables that are subject to the netting agreement with a counterparty can be determined at any time; and

(C) For internal risk management purposes, the broker-dealer monitors and controls its exposure to the counterparty on a net basis;

(v) *Collateral.* When calculating maximum potential exposure and current exposure to a counterparty, the fair market value of collateral pledged and held may be taken into account provided:

(A) The collateral is marked to market each day and is subject to a daily margin maintenance requirement;

(B) The collateral is subject to the broker's or dealer's physical possession or control;

(1) The collateral is subject to the broker's or dealer's physical possession or control and may be liquidated promptly by the firm without intervention by any other party; or

(2) The collateral is held by an independent third-party custodian that is a bank as defined in section 3(a)(6) of the

Act or a registered U.S. clearing organization or depository that is not affiliated with the counterparty or, if the collateral consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that is not affiliated with the counterparty and that customarily maintains custody of such foreign securities or currencies;

(C) The collateral is liquid and transferable;

(D) The collateral agreement is legally enforceable by the broker or dealer against the counterparty and any other parties to the agreement;

(E) The collateral does not consist of securities issued by the counterparty or a party related to the broker or dealer or to the counterparty;

(F) The Commission has approved the broker's or dealer's use of a VaR model to calculate deductions for market risk for the type of collateral in accordance with this appendix E; and

(G) The collateral is not used in determining the credit rating of the counterparty;

(vi) *Credit risk weights of counterparties.* A broker or dealer that computes its deductions for credit risk pursuant to this Appendix E shall apply a credit risk weight for transactions with a counterparty of either 20%, 50%, or 150% based on an internal credit rating the broker or dealer determines for the counterparty.

(A) As part of its initial application or in an amendment, the broker or dealer may request Commission approval to apply a credit risk weight of either 20%, 50%, or 150% based on internal calculations of credit ratings, including internal estimates of the maturity adjustment. Based on the strength of the broker's or dealer's internal credit risk management system, the Commission may approve the application. The broker or dealer must make and keep current a record of the basis for the credit rating of each counterparty;

(B) For the portion of a current exposure covered by a written guarantee where that guarantee is an unconditional and irrevocable guarantee of the due and punctual payment and performance of the obligation and the broker or dealer can demand imme-

diately payment from the guarantor after any payment is missed without having to make collection efforts, the broker or dealer may substitute the credit risk weight of the guarantor for the credit risk weight of the counterparty; and

(C) As part of its initial application or in an amendment, the broker or dealer may request Commission approval to reduce deductions for credit risk through the use of credit derivatives.

VaR Models

(d) To be approved, each VaR model must meet the following minimum qualitative and quantitative requirements:

(1) *Qualitative requirements.* (i) The VaR model used to calculate market or credit risk for a position must be integrated into the daily internal risk management system of the broker or dealer;

(ii) The VaR model must be reviewed both periodically and annually. The periodic review may be conducted by the broker's or dealer's internal audit staff, but the annual review must be conducted by a registered public accounting firm, as that term is defined in section 2(a)(12) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 *et seq.*); and

(iii) For purposes of computing market risk, the broker or dealer must determine the appropriate multiplication factor as follows:

(A) Beginning three months after the broker or dealer begins using the VaR model to calculate market risk, the broker or dealer must conduct backtesting of the model by comparing its actual daily net trading profit or loss with the corresponding VaR measure generated by the VaR model, using a 99 percent, one-tailed confidence level with price changes equivalent to a one business-day movement in rates and prices, for each of the past 250 business days, or other period as may be appropriate for the first year of its use;

(B) On the last business day of each quarter, the broker or dealer must identify the number of backtesting exceptions of the VaR model, that is, the number of business days in the past 250 business days, or other period as may

be appropriate for the first year of its use, for which the actual net trading loss, if any, exceeds the corresponding VaR measure; and

(C) The broker or dealer must use the multiplication factor indicated in Table 1 of this appendix E in determining its market risk until it obtains the next quarter's backtesting results;

TABLE 1—MULTIPLICATION FACTOR BASED ON THE NUMBER OF BACKTESTING EXCEPTIONS OF THE VaR MODEL

| Number of exceptions | Multiplication factor |
|----------------------|-----------------------|
| 4 or fewer | 3.00 |
| 5 | 3.40 |
| 6 | 3.50 |
| 7 | 3.65 |
| 8 | 3.75 |
| 9 | 3.85 |
| 10 or more | 4.00 |

(iv) For purposes of incorporating specific risk into a VaR model, a broker or dealer must demonstrate that it has methodologies in place to capture liquidity, event, and default risk adequately for each position. Furthermore, the models used to calculate deductions for specific risk must:

(A) Explain the historical price variation in the portfolio;

(B) Capture concentration (magnitude and changes in composition);

(C) Be robust to an adverse environment; and

(D) Be validated through backtesting; and

(v) For purposes of computing the credit equivalent amount of the broker's or dealer's exposures to a counterparty, the broker or dealer must determine the appropriate multiplication factor as follows:

(A) Beginning three months after it begins using the VaR model to calculate maximum potential exposure, the broker or dealer must conduct backtesting of the model by comparing, for at least 80 counterparties with widely varying types and sizes of positions with the firm, the ten-business day change in its current exposure to the counterparty based on its positions held at the beginning of the ten-business day period with the corresponding ten-business day maximum potential exposure for the

counterparty generated by the VaR model;

(B) As of the last business day of each quarter, the broker or dealer must identify the number of backtesting exceptions of the VaR model, that is, the number of ten-business day periods in the past 250 business days, or other period as may be appropriate for the first year of its use, for which the change in current exposure to a counterparty exceeds the corresponding maximum potential exposure; and

(C) The broker or dealer will propose, as part of its application, a schedule of multiplication factors, which must be approved by the Commission based on the number of backtesting exceptions of the VaR model. The broker or dealer must use the multiplication factor indicated in the approved schedule in determining the credit equivalent amount of its exposures to a counterparty until it obtains the next quarter's backtesting results, unless the Commission determines, based on, among other relevant factors, a review of the broker's or dealer's internal risk management control system, including a review of the VaR model, that a different adjustment or other action is appropriate;

(2) *Quantitative requirements.* (i) For purposes of determining market risk, the VaR model must use a 99 percent, one-tailed confidence level with price changes equivalent to a ten business-day movement in rates and prices;

(ii) For purposes of determining maximum potential exposure, the VaR model must use a 99 percent, one-tailed confidence level with price changes equivalent to a one-year movement in rates and prices; or based on a review of the broker's or dealer's procedures for managing collateral and if the collateral is marked to market daily and the broker or dealer has the ability to call for additional collateral daily, the Commission may approve a time horizon of not less than ten business days;

(iii) The VaR model must use an effective historical observation period of at least one year. The broker or dealer must consider the effects of market stress in its construction of the model. Historical data sets must be updated at least monthly and reassessed whenever

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market prices or volatilities change significantly; and

(iv) The VaR model must take into account and incorporate all significant, identifiable market risk factors applicable to positions in the accounts of the broker or dealer, including:

(A) Risks arising from the non-linear price characteristics of derivatives and the sensitivity of the market value of those positions to changes in the volatility of the derivatives' underlying rates and prices;

(B) Empirical correlations with and across risk factors or, alternatively, risk factors sufficient to cover all the market risk inherent in the positions in the proprietary or other trading accounts of the broker or dealer, including interest rate risk, equity price risk, foreign exchange risk, and commodity price risk;

(C) Spread risk, where applicable, and segments of the yield curve sufficient to capture differences in volatility and imperfect correlation of rates along the yield curve for securities and derivatives that are sensitive to different interest rates; and

(D) Specific risk for individual positions.

Additional Conditions

(e) As a condition for the broker or dealer to use this appendix E to calculate certain of its capital charges, the Commission may impose additional conditions on the broker or dealer, which may include, but are not limited to restricting the broker's or dealer's business on a product-specific, category-specific, or general basis; submitting to the Commission a plan to increase the broker's or dealer's net capital or tentative net capital; filing more frequent reports with the Commission; modifying the broker's or dealer's internal risk management control procedures; or computing the broker's or dealer's deductions for market and credit risk in accordance with § 240.15c3-1(c)(2)(iv), (vi), and (vii), (c)(2)(xv)(A) and (B), as appropriate, and § 240.15c-1b, as appropriate. If it is not an ultimate holding company that has a principal regulator, the Commission also may require, as a condition of continuation of the exemption, the ultimate holding company of the broker

or dealer to file more frequent reports or to modify its group-wide internal risk management control procedures. If the Commission finds it is necessary or appropriate in the public interest or for the protection of investors, the Commission may impose additional conditions on either the broker-dealer, or the ultimate holding company, if it is an ultimate holding company that does not have a principal regulator, if:

(1) The broker or dealer is required by § 240.15c3-1(a)(7)(ii) to provide notice to the Commission that the broker's or dealer's tentative net capital is less than \$6 billion;

(2) The broker or dealer or the ultimate holding company of the broker or dealer fails to meet the reporting requirements set forth in § 240.17a-5 or 240.15c3-1g(b), as applicable;

(3) Any event specified in § 240.17a-11 occurs;

(4) There is a material deficiency in the internal risk management control system or in the mathematical models used to price securities or to calculate deductions for market and credit risk or allowances for market and credit risk, as applicable, of the broker or dealer or the ultimate holding company of the broker or dealer;

(5) The ultimate holding company of the broker or dealer fails to comply with its undertakings that the broker or dealer has filed with its application pursuant to paragraph (a)(1)(viii) or (a)(1)(ix) of this appendix E;

(6) The broker or dealer fails to comply with this appendix E; or

(7) The Commission finds that imposition of other conditions is necessary or appropriate in the public interest or for the protection of investors.

[69 FR 34462, June 21, 2004, as amended at 79 FR 1549, Jan. 8, 2014; 79 FR 38451, July 8, 2014; 84 FR 44046, Aug. 22, 2019]

§ 240.15c3-1f Optional market and credit risk requirements for OTC derivatives dealers (Appendix F to 17 CFR 240.15c3-1).

Application Requirements

(a) An OTC derivatives dealer may apply to the Commission for authorization to compute capital charges for market and credit risk pursuant to this

Appendix F in lieu of computing securities haircuts pursuant to §240.15c3-1(c)(2)(vi).

(1) An OTC derivatives dealer's application shall contain the following information:

(i) *Executive summary.* An OTC derivatives dealer shall include in its application an Executive Summary of information provided to the Commission.

(ii) *Description of methods for computing market risk charges.* An OTC derivatives dealer shall provide a description of all statistical models used for pricing OTC derivative instruments and for computing value-at-risk ("VAR"), a description of the applicant's controls over those models, and a statement regarding whether the firm has developed its own internal VAR models. If the OTC derivatives dealer's VAR model incorporates empirical correlations across risk categories, the dealer shall describe its process for measuring correlations and describe the qualitative and quantitative aspects of the model which at a minimum must adhere to the criteria set forth in paragraph (e) of this appendix F. The application shall further state whether the OTC derivatives dealer intends to use an alternative method for computing its market risk charge for equity instruments and, if applicable, a description of how its own theoretical pricing model contains the minimum pricing factors set forth in appendix A (§240.15c3-1a). The application shall also describe any category of securities having no ready market or any category of debt securities which are below investment grade for which the OTC derivatives dealer wishes to use its VAR model to calculate its market risk charge or for which it wishes to use an alternative method for computing this charge and a description of how those charges would be determined.

(iii) *Internal risk management control systems.* An OTC derivatives dealer shall provide a comprehensive description of its internal risk management control systems and how those systems adhere to the requirements set forth in §240.15c3-4(a) through (d).

(2) The Commission may approve the application after reviewing the applica-

tion to determine whether the OTC derivatives dealer:

(i) Has adopted internal risk management control systems that meet the requirements set forth in §240.15c3-4; and

(ii) Has adopted a VAR model that meets the requirements set forth in paragraphs (e)(1) and (e)(2) of this appendix F.

(3) If the OTC derivatives dealer materially amends its VAR model or internal risk management control systems as described in its application, including any material change in the categories of non-marketable securities that it wishes to include in its VAR model, the dealer shall file an application describing the changes which must be approved by the Commission before the changes may be implemented. After reviewing the application for changes to the dealer's VAR model or internal risk management control systems to determine whether, with the changes, the OTC derivatives dealer's VAR model and internal risk management control systems would meet the requirements set forth in this appendix F and §240.15c3-4, the Commission may approve the application.

(4) The applications provided for in this paragraph (a) shall be considered filed when received at the Commission's principal office in Washington, DC. All applications filed pursuant to this paragraph (a) shall be deemed to be confidential.

Compliance With §240.15c3-4

(b) An OTC derivatives dealer must be in compliance in all material respects with §240.15c3-4 regarding its internal risk management control systems in order to be in compliance with §240.15c3-1.

Market Risk

(c) An OTC derivatives dealer electing to apply this appendix F shall compute a capital charge for market risk which shall be the aggregate of the charges computed below:

(1) *Value-at-Risk.* An OTC derivatives dealer shall deduct from net worth an amount for market risk for eligible OTC derivative instruments and other positions in its proprietary or other accounts equal to the VAR of these positions obtained from its proprietary

VAR model, multiplied by the appropriate multiplication factor in paragraph (e)(1)(iv)(C) of this appendix F. The OTC derivatives dealer may not elect to calculate its capital charges under this paragraph (c)(1) until its application to use the VAR model has been approved by the Commission.

(2) *Alternative method for equities.* An OTC derivatives dealer may elect to use this alternative method to calculate its market risk for equity instruments, including OTC options, upon approval by the Commission on application by the dealer. Under this alternative method, the deduction for market risk must be the amount computed pursuant to appendix A to Rule 15c3-1

(§ 240.15c3-1a). In this computation, the OTC derivatives dealer may use its own theoretical pricing model provided that it contains the minimum pricing factors set forth in appendix A.

(3) *Non-marketable securities.* An OTC derivatives dealer may not use a VAR model to determine a capital charge for any category of securities having no ready market or any category of debt securities which are below investment grade or any derivative instrument based on the value of these categories of securities, unless the Commission has granted, pursuant to paragraph (a)(1) of this appendix F, its application to use its VAR model for any such category of securities. The dealer in any event may apply, pursuant to paragraph (a)(1) of this appendix F, for an alternative treatment for any such category of securities, rather than calculate the market risk capital charge for such category of securities under § 240.15c3-1(c)(2)(vi) and (vii).

(4) *Residual positions.* To the extent that a position has not been included in the calculation of the market risk charge in paragraphs (c)(1) through (c)(3) of this section, the market risk charge for the position shall be computed under § 240.15c3-1(c)(2)(vi).

Credit Risk

(d) The capital charge for credit risk arising from an OTC derivatives dealer's transactions in eligible OTC derivative instruments shall be:

(1) The net replacement value in the account of a counterparty (including

the effect of legally enforceable netting agreements and the application of liquid collateral) that is insolvent, or in bankruptcy, or that has senior unsecured long-term debt in default;

(2) As to a counterparty not otherwise described in paragraph (d)(1) of this section, the net replacement value in the account of the counterparty (including the effect of legally enforceable netting agreements and the application of liquid collateral) multiplied by 8%, and further multiplied by a counterparty factor of 20%, 50%, or 100% based on an internal credit rating the OTC derivatives dealer determines for the counterparty; and

(3) A concentration charge where the net replacement value in the account of any one counterparty (other than a counterparty described in paragraph (d)(1) of this section) exceeds 25% of the OTC derivatives dealer's tentative net capital, calculated as follows:

(i) For counterparties for which an OTC derivatives dealer assigns an internal rating for senior unsecured long-term debt or commercial paper that would apply a 20% counterparty factor under paragraph (d)(2) of this section, 5% of the amount of the net replacement value in excess of 25% of the OTC derivatives dealer's tentative net capital;

(ii) For counterparties for which an OTC derivatives dealer assigns an internal rating for senior unsecured long-term debt that would apply a 50% counterparty factor under paragraph (d)(2) of this section, 20% of the amount of the net replacement value in excess of 25% of the OTC derivatives dealer's tentative net capital;

(iii) For counterparties for which an OTC derivatives dealer assigns an internal rating for senior unsecured long-term debt that would apply a 100% counterparty factor under paragraph (d)(2) of this section, 50% of the amount of the net replacement value in excess of 25% of the OTC derivatives dealer's tentative net capital.

(4) Counterparties may be rated by the OTC derivatives dealer, or by an affiliated bank or affiliated broker-dealer of the OTC derivatives dealer, upon approval by the Commission on application by the OTC derivatives dealer.

Based on the strength of the OTC derivatives dealer's internal credit risk management system, the Commission may approve the application. The OTC derivatives dealer must make and keep current a record of the basis for the credit rating for each counterparty.

VAR Models

(e) An OTC derivatives dealer's VAR model must meet the following qualitative and quantitative requirements:

(1) *Qualitative requirements.* An OTC derivatives dealer applying this appendix F must have a VAR model that meets the following minimum qualitative requirements:

(i) The OTC derivatives dealer's VAR model must be integrated into the firm's daily risk management process;

(ii) The OTC derivatives dealer must conduct appropriate stress tests of the VAR model, and develop appropriate procedures to follow in response to the results of such tests;

(iii) The OTC derivatives dealer must conduct periodic reviews (which may be performed by internal audit staff) of its VAR model. The OTC derivatives dealer's VAR model also must be subject to annual reviews conducted by independent public accountants; and

(iv) The OTC derivatives dealer must conduct backtesting of the VAR model pursuant to the following procedures:

(A) Beginning one year after the OTC derivatives dealer begins using its VAR model to calculate its net capital, the OTC derivatives dealer must conduct backtesting by comparing each of its most recent 250 business days' actual net trading profit or loss with the corresponding daily VAR measures generated for determining market risk capital charges and calibrated to a one-day holding period and a 99 percent, one-tailed confidence level;

(B) Once each quarter, the OTC derivatives dealer must identify the number of exceptions, that is, the number of business days for which the actual daily net trading loss, if any, exceeded the corresponding daily VAR measure; and

(C) An OTC derivatives dealer must use the multiplication factor indicated in Table 1 of this appendix F in determining its capital charge for market risk until it obtains the next quarter's

backtesting results, unless the Commission determines that a different adjustment or other action is appropriate.

TABLE 5—MULTIPLICATION FACTOR BASED ON RESULTS OF BACKTESTING

| Number of exceptions | Multiplication factor |
|----------------------|-----------------------|
| 4 or fewer | 3.00 |
| 5 | 3.40 |
| 6 | 3.50 |
| 7 | 3.65 |
| 8 | 3.75 |
| 9 | 3.85 |
| 10 or more | 4.00 |

(2) *Quantitative requirements.* An OTC derivatives dealer applying this appendix F must have a VAR model that meets the following minimum quantitative requirements:

(i) The VAR measures must be calculated on a daily basis using a 99 percent, one-tailed confidence level with a price change equivalent to a ten-business day movement in rates and prices;

(ii) The effective historical observation period for VAR measures must be at least one year, and the weighted average time lag of the individual observations cannot be less than six months. Historical data sets must be updated at least every three months and reassessed whenever market prices or volatilities are subject to large changes;

(iii) The VAR measures must include the risks arising from the non-linear price characteristics of options positions and the sensitivity of the market value of the positions to changes in the volatility of the underlying rates or prices. An OTC derivatives dealer must measure the volatility of options positions by different maturities;

(iv) The VAR measures may incorporate empirical correlations within and across risk categories, provided that the OTC derivatives dealer has described its process for measuring correlations in its application to apply this appendix F and the Commission has approved its application. In the event that the VAR measures do not incorporate empirical correlations across risk categories, the OTC derivatives dealer must add the separate VAR measures for the four major risk

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categories in paragraph (e)(2)(v) of this appendix F to determine its aggregate VAR measure; and

(v) The OTC derivatives dealer's VAR model must use risk factors sufficient to measure the market risk inherent in all covered positions. The risk factors must address, at a minimum, the following major risk categories: interest rate risk, equity price risk, foreign exchange rate risk, and commodity price risk. For material exposures in the major currencies and markets, modeling techniques must capture, at a minimum, spread risk and must incorporate enough segments of the yield curve to capture differences in volatility and less-than-perfect correlation of rates along the yield curve. An OTC derivatives dealer must provide the Commission with evidence that the OTC derivatives dealer's VAR model takes account of specific risk in positions, including specific equity risk, if the OTC derivatives dealer intends to utilize its VAR model to compute capital charges for equity price risk.

[63 FR 59398, Nov. 3, 1998, as amended at 79 FR 1549, Jan. 8, 2014]

§ 240.15c3-1g Conditions for ultimate holding companies of certain brokers or dealers (Appendix G to 17 CFR 240.15c3-1).

As a condition for a broker or dealer to compute certain of its deductions to capital in accordance with § 240.15c3-1e, pursuant to its undertaking, the ultimate holding company of the broker or dealer shall:

CONDITIONS REGARDING COMPUTATION OF ALLOWABLE CAPITAL AND RISK ALLOWANCES

(a) If it is not an ultimate holding company that has a principal regulator, as that term is defined in § 240.15c3-1(c)(13), calculate allowable capital and allowances for market, credit, and operational risk on a consolidated basis as follows:

(1) *Allowable capital.* The ultimate holding company must compute allowable capital as the sum of:

(i) Common shareholders' equity on the consolidated balance sheet of the holding company less:

(A) Goodwill;

(B) Deferred tax assets, except those permitted for inclusion in Tier 1 capital by the Board of Governors of the Federal Reserve System ("Federal Reserve") (12 CFR 225, appendix A);

(C) Other intangible assets; and

(D) Other deductions from common stockholders' equity as required by the Federal Reserve in calculating Tier 1 capital (as defined in 12 CFR 225, appendix A);

(ii) Cumulative and non-cumulative preferred stock, except that the amount of cumulative preferred stock may not exceed 33% of the items included in allowable capital pursuant to paragraph (a)(1)(i) of this appendix G, excluding cumulative preferred stock, provided that:

(A) The stock does not have a maturity date;

(B) The stock cannot be redeemed at the option of the holder of the instrument;

(C) The stock has no other provisions that will require future redemption of the issue; and

(D) The issuer of the stock can defer or eliminate dividends;

(iii) The sum of the following items on the consolidated balance sheet, to the extent that the sum does not exceed the sum of the items included in allowable capital pursuant to paragraphs (a)(1)(i) and (ii) of this Appendix G:

(A) Cumulative preferred stock in excess of the 33% limit specified in paragraph (a)(1)(ii) of this appendix G and subject to the conditions of paragraphs (a)(1)(ii)(A) through (D) of this appendix G;

(B) Subordinated debt if the original weighted average maturity of the subordinated debt is at least five years; each subordinated debt instrument states clearly on its face that repayment of the debt is not protected by any Federal agency or the Securities Investor Protection Corporation; the subordinated debt is unsecured and subordinated in right of payment to all senior indebtedness of the ultimate holding company; and the subordinated debt instrument permits acceleration only in the event of bankruptcy or reorganization of the ultimate holding company under Chapters 7 (liquidation)

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and 11 (reorganization) of the U.S. Bankruptcy Code; and

(C) As part of the broker's or dealer's application to calculate deductions for market and credit risk under § 240.15c3-1e, an ultimate holding company may request to include, for a period of three years after adoption of this appendix G, long-term debt that has an original weighted average maturity of at least five years and that cannot be accelerated, except upon the occurrence of certain events as the Commission may approve. As part of a subsequent amendment to the broker's or dealer's application, the broker or dealer may request permission for the ultimate holding company to include long-term debt that meets these criteria in allowable capital for up to an additional two years; and

(iv) Hybrid capital instruments that are permitted for inclusion in Tier 2 capital by the Federal Reserve (as defined in 12 CFR 225, appendix A);

(2) *Allowance for market risk.* The ultimate holding company shall compute an allowance for market risk for all proprietary positions, including debt instruments, equity instruments, commodity instruments, foreign exchange contracts, and derivative contracts, as the aggregate of the following:

(i) *Value at risk.* The VaR of its positions, multiplied by the appropriate multiplication factor as set forth in § 240.15c3-1e(d). The VaR of the positions must be obtained using approved VaR models meeting the applicable qualitative and quantitative requirements of § 240.15c3-1e(d); and

(ii) *Alternative method.* For positions for which there does not exist adequate historical data to support a VaR model, the ultimate holding company must propose a model that produces a suitable allowance for market risk for those positions;

(3) *Allowance for credit risk.* The ultimate holding company shall compute an allowance for credit risk for certain assets on the consolidated balance sheet and certain off-balance sheet items, including loans and loan commitments, exposures due to derivatives contracts, structured financial products, and other extensions of credit, and credit substitutes as follows:

(i) By multiplying the credit equivalent amount of the ultimate holding company's exposure to the counterparty, as defined in paragraphs (a)(3)(i)(A), (B) and (C) of this appendix G, by the appropriate credit risk weight, as defined in paragraph (a)(3)(i)(F) of this appendix G, of the asset, off-balance sheet item, or counterparty, then multiplying that product by 8%, in accordance with the following:

(A) For certain loans and loan commitments, the credit equivalent amount is determined by multiplying the nominal amount of the contract by the following credit conversion factors:

(1) 0% credit conversion factor for loan commitments that:

(i) May be unconditionally cancelled by the lender; or

(ii) May be cancelled by the lender due to credit deterioration of the borrower;

(2) 20% credit conversion factor for:

(i) Loan commitments of less than one year; or

(ii) Short-term self-liquidating trade related contingencies, including letters of credit;

(3) 50% credit conversion factor for loan commitments with an original maturity of greater than one year that contain transaction contingencies, including performance bonds, revolving underwriting facilities, note issuance facilities and bid bonds; and

(4) 100% credit conversion factor for bankers' acceptances, stand-by letters of credit, and forward purchases of assets, and similar direct credit substitutes;

(B) For derivatives contracts and for repurchase agreements, reverse repurchase agreements, stock lending and borrowing, and similar collateralized transactions, the credit equivalent amount is the sum of the ultimate holding company's maximum potential exposure to the counterparty, as defined in paragraph (a)(3)(i)(E) of this appendix G, multiplied by the appropriate multiplication factor, and the ultimate holding company's current exposure to the counterparty, as defined in paragraph (a)(3)(i)(D) of this appendix G. The ultimate holding company must use the multiplication factor determined according to § 240.15c3-

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1e(d)(1)(v), except that the initial multiplication factor shall be one, unless the Commission determines, based on a review of the group-wide internal risk management control system and practices, including a review of the VaR models, that another multiplication factor is appropriate;

(C) The credit equivalent amount for other assets shall be the asset's book value on the ultimate holding company's consolidated balance sheet or other amount as determined according to the standards published by the Basel Committee on Banking Supervision, as amended from time to time;

(D) The *current exposure* is the current replacement value of a counterparty's positions, after applying netting agreements with that counterparty meeting the requirements of § 240.15c3-1e(c)(4)(iv) and taking into account the value of collateral from the counterparty in accordance with § 240.15c3-1e(c)(4)(v);

(E) The *maximum potential exposure* is the VaR of the counterparty's positions with the member of the affiliate group, after applying netting agreements with the counterparty meeting the requirements of paragraph (c)(4)(iv) of § 240.15c3-1e, taking into account the value of collateral from the counterparty held by the member of the affiliate in accordance with paragraph (c)(4)(v) of § 240.15c3-1e, and taking into account the current replacement value of the counterparty's positions with the member of the affiliate group, except that for repurchase agreements, reverse repurchase agreements, stock lending and borrowing, and similar collateralized transactions, maximum potential exposure must be calculated using a time horizon of not less than five days;

(F) Credit ratings and credit risk weights shall be determined according to the provisions of paragraphs (c)(4)(vi)(A) and (c)(4)(vi)(B) of § 240.15c3-1e, respectively;

(G) As part of the broker's or dealer's initial application or in an amendment, the ultimate holding company may request Commission approval to reduce allowances for credit risk through the use of credit derivatives;

(H) For the portion of a current exposure covered by a written guarantee,

where that guarantee is an unconditional and irrevocable guarantee of the due and punctual payment and performance of the obligation and the ultimate holding company or member of the affiliate group can demand payment after any payment is missed without having to make collection efforts, the ultimate holding company or member of the affiliate group may substitute the credit risk weight of the guarantor for the credit risk weight of the counterparty; or

(ii) As part of the broker's or dealer's initial application or in an amendment to the application, the ultimate holding company may request Commission approval to use a method of calculating credit risk that is consistent with standards published by the Basel Committee on Banking Supervision in International Convergence of Capital Measurement and Capital Standards (July 1988), as amended from time to time; and

(4) *Allowance for operational risk.* The ultimate holding company shall compute an allowance for operational risk in accordance with the standards published by the Basel Committee on Banking Supervision, as amended from time to time.

CONDITIONS REGARDING REPORTING REQUIREMENTS

(b) File reports with the Commission in accordance with the following:

(1) If it is not an ultimate holding company that has a principal regulator, as that term is defined in § 240.15c3-1(c)(13), the ultimate holding company shall file with the Commission:

(i) A report as of the end of each month, filed not later than 30 calendar days after the end of the month. A monthly report need not be filed for a month-end that coincides with a fiscal quarter-end. The monthly report shall include:

(A) A consolidated balance sheet and income statement (including notes to the financial statements) for the ultimate holding company and statements of allowable capital and allowances for market, credit, and operational risk computed pursuant to paragraph (a) of this appendix G, *except* that the consolidated balance sheet and income

statement for the first month of the fiscal year may be filed at a later time to which the Commission agrees (when reviewing the affiliated broker's or dealer's application under § 240.15c3-1e(a)). A statement of comprehensive income (as defined in § 210.1-02 of Regulation S-X of this chapter) shall be included in place of an income statement, if required by the applicable generally accepted accounting principles.

(B) A graph reflecting, for each business line, the daily intra-month VaR;

(C) Consolidated credit risk information, including aggregate current exposure and current exposures (including commitments) listed by counterparty for the 15 largest exposures;

(D) The 10 largest commitments listed by counterparty;

(E) Maximum potential exposure listed by counterparty for the 15 largest exposures;

(F) The aggregate maximum potential exposure;

(G) A summary report reflecting the geographic distribution of the ultimate holding company's exposures on a consolidated basis for each of the top ten countries to which it is exposed (by residence of the main operating group of the counterparty); and

(H) Certain regular risk reports provided to the persons responsible for managing group-wide risk as the Commission may request from time to time;

(ii) A quarterly report as of the end of each fiscal quarter, filed not later than 35 calendar days after the end of the quarter. The quarterly report shall include, in addition to the information contained in the monthly report as required by paragraph (b)(1)(i) of this appendix G, the following:

(A) Consolidating balance sheets and income statements for the ultimate holding company. The consolidating balance sheet must provide information regarding each material affiliate of the ultimate holding company in a separate column, but may aggregate information regarding members of the affiliate group that are not material affiliates into one column. Statements of comprehensive income (as defined in § 210.1-02 of Regulation S-X) shall be included in place of an income state-

ment, if required by the applicable generally accepted accounting principles;

(B) The results of backtesting of all internal models used to compute allowable capital and allowances for market and credit risk indicating, for each model, the number of backtesting exceptions;

(C) A description of all material pending legal or arbitration proceedings, involving either the ultimate holding company or any of its affiliates, that are required to be disclosed by the ultimate holding company under generally accepted accounting principles;

(D) The aggregate amount of unsecured borrowings and lines of credit, segregated into categories, scheduled to mature within twelve months from the most recent fiscal quarter as to each material affiliate; and

(E) For a quarter-end that coincides with the ultimate holding company's fiscal year-end, the ultimate holding company need not include consolidated and consolidating balance sheets and income statements (or statements of comprehensive income, as applicable) in its quarterly reports. The consolidating balance sheet and income statement (or statement of comprehensive income, as applicable) for the quarter-end that coincides with the fiscal year-end may be filed at a later time to which the Commission agrees (when reviewing the affiliated broker's or dealer's application under § 240.15c3-1e(a));

(iii) An annual audited report as of the end of the ultimate holding company's fiscal year, filed not later than 65 calendar days after the end of the fiscal year. The annual report shall include:

(A) Consolidated financial statements for the ultimate holding company audited by a registered public accounting firm, as that term is defined in section 2(a)(12) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 *et seq.*). The audit shall be made in accordance with the rules promulgated by the Public Company Accounting Oversight Board. The audited financial statements must include a supporting schedule containing statements of allowable capital and allowances for market, credit, and operational risk

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computed pursuant to paragraph (a) of this appendix G; and

(B) A supplemental report entitled “Accountant’s Report on Internal Risk Management Control System” prepared by a registered public accounting firm, as that term is defined in section 2(a)(12) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 *et seq.*), indicating the results of the registered public accounting firm’s review of the ultimate holding company’s compliance with § 240.15c3-4. The procedures are to be performed and the report is to be prepared in accordance with procedures agreed upon by the ultimate holding company and the registered public accounting firm conducting the review. The agreed-upon procedures are to be performed and the report is to be prepared in accordance with rules promulgated by the Public Company Accounting Oversight Board. The ultimate holding company must file, before commencement of the initial review, the procedures agreed upon by the ultimate holding company and the registered public accounting firm with the Division of Market Regulation, Office of Financial Responsibility, at Commission’s principal office in Washington, DC. Before commencement of each subsequent review, the ultimate holding company must notify the Commission of any changes in the procedures;

(iv) An organizational chart, as of the ultimate holding company’s fiscal year-end, concurrently with its quarterly report for the quarter-end that coincides with its fiscal year-end. The ultimate holding company must provide quarterly updates of the organizational chart if a material change in the information provided to the Commission has occurred;

(2) If the ultimate holding company is an entity that has a principal regulator, as that term is defined in § 240.15c3-1(c)(13), the ultimate holding company must file with the Commission:

(i) A quarterly report as of the end of each fiscal quarter, filed not later than 35 calendar days after the end of the quarter, or a later time to which the Commission may agree upon application. The quarterly report shall include:

(A) Consolidated (including notes to the financial statements) and consolidating balance sheets and income statements for the ultimate holding company. Statements of comprehensive income (as defined in § 210.1-02 of Regulation S-X) shall be included in place of income statements, if required by the applicable generally accepted accounting principles;

(B) Its most recent capital measurements computed in accordance with the standards published by the Basel Committee on Banking Supervision, as amended from time to time, as reported to its principal regulator;

(C) Certain regular risk reports provided to the persons responsible for managing group-wide risk as the Commission may request from time to time; and

(D) For a quarter-end that coincides with the ultimate holding company’s fiscal year-end, the ultimate holding company need not include consolidated and consolidating balance sheets and income statements (or statements of comprehensive income, as applicable) in its quarterly reports. The consolidating balance sheet and income statement (or statement of comprehensive income, as applicable) for the quarter-end that coincides with the fiscal year-end may be filed at a later time to which the Commission agrees (when reviewing the affiliated broker’s or dealer’s application under § 240.15c3-1e(a)).

(ii) An annual audited report as of the end of the ultimate holding company’s fiscal year, filed with the Commission when required to be filed by any regulator;

(3) The reports that the ultimate holding company must file in accordance with paragraph (b) of this appendix G will be considered filed when two copies are received at the Commission’s principal office in Washington, DC. A person who files reports pursuant to this section for which he or she seeks confidential treatment may clearly mark each page or segregable portion of each page with the words “Confidential Treatment Requested.” The copies shall be addressed to the Division of Market Regulation, Risk Assessment Group; and

(4) The reports that the ultimate holding company must file with the

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Commission in accordance with paragraph (b) of this Appendix G will be accorded confidential treatment to the extent permitted by law.

CONDITIONS REGARDING RECORDS TO BE MADE

(c) If it is not an ultimate holding company that has a principal regulator, make and keep current the following records:

(1) A record of the results of funding and liquidity stress tests that the ultimate holding company has conducted in response to the following events at least once each quarter and a record of the contingency plan to respond to each of these events:

(i) A credit rating downgrade of the ultimate holding company;

(ii) An inability of the ultimate holding company to access capital markets for unsecured short-term funding;

(iii) An inability of the ultimate holding company to access liquid assets in regulated entities across international borders when the events described in paragraphs (c)(1)(i) or (ii) of this appendix G occur; and

(iv) An inability of the ultimate holding company to access credit or assets held at a particular institution when the events described in paragraphs (c)(1)(i) or (ii) of this appendix G occur;

(2) A record of the basis for the determination of credit risk weights for each counterparty;

(3) A record of the basis for the determination of internal credit ratings for each counterparty; and

(4) A record of the calculations of allowable capital and allowances for market, credit and operational risk computed currently at least once per month on a consolidated basis.

CONDITIONS REGARDING PRESERVATION OF RECORDS

(d)(1) Must preserve the following information, documents, and reports for a period of not less than three years in an easily accessible place using any media acceptable under § 240.17a-4(f):

(i) The documents created in accordance with paragraph (c) of this Appendix G;

(ii) Any application or documents filed with the Commission pursuant to

§ 240.15c3-1e and this appendix G and any written responses received from the Commission;

(iii) All reports and notices filed with the Commission pursuant to § 240.15c3-1e and this appendix G; and

(iv) If the ultimate holding company does not have a principal regulator, all written policies and procedures concerning the group-wide internal risk management control system established pursuant to § 240.15c3-1e(a)(1)(viii)(C); and

(2) The ultimate holding company may maintain the records referred to in paragraph (d)(1) of this appendix G either at the ultimate holding company, at an affiliate, or at a records storage facility, provided that the records are located within the United States. If the records are maintained by an entity other than the ultimate holding company, the ultimate holding company shall obtain and file with the Commission a written undertaking by the entity maintaining the records, in a form acceptable to the Commission, signed by a duly authorized person at the entity maintaining the records, to the effect that the records will be treated as if the ultimate holding company were maintaining the records pursuant to this section and that the entity maintaining the records will permit examination of such records at any time or from time to time during business hours by representatives or designees of the Commission and will promptly furnish the Commission or its designee a true, legible, complete, and current paper copy of any or all or any part of such records. The election to operate pursuant to the provisions of this paragraph shall not relieve the ultimate holding company that is required to maintain and preserve such records from any of its reporting or recordkeeping responsibilities under this section.

CONDITIONS REGARDING NOTIFICATION

(e) The ultimate holding company of a broker or dealer that computes certain of its capital charges in accordance with § 240.15c3-1e shall:

(1) Send notice promptly (but within 24 hours) after the occurrence of the following events:

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(i) The early warning indications of low capital as the Commission may agree;

(ii) The ultimate holding company files a Form 8-K (17 CFR 249.308) with the Commission; and

(iii) A material affiliate declares bankruptcy or otherwise becomes insolvent; and

(2) If it is not an ultimate holding company that has a principal regulator, as defined in § 240.15c3-1(c)(13), send notice promptly (but within 24 hours) after the occurrence of the following events:

(i) The ultimate holding company becomes aware that an NRSRO has determined to reduce materially its assessment of the creditworthiness of a material affiliate or the credit rating(s) assigned to one or more outstanding short or long-term obligations of a material affiliate;

(ii) The ultimate holding company becomes aware that any financial regulatory agency or self-regulatory organization has taken significant enforcement or regulatory action against a material affiliate; and

(iii) The occurrence of any backtesting exception under § 240.15c3-1e(d)(1)(iii) or (iv) that would require that the ultimate holding company use a higher multiplication factor in the calculation of its allowances for market or credit risk;

(3) Every notice given or transmitted by paragraph (e) of this appendix G will be given or transmitted to the Division of Market Regulation, Office of Financial Responsibility, at the principal office of the Commission in Washington, DC. A person who files notification pursuant to this section for which he or she seeks confidential treatment may clearly mark each page or segregable portion of each page with the words "Confidential Treatment Request." For the purposes of this appendix G, "notice" shall be given or transmitted by telegraphic notice or facsimile transmission. The notice described by paragraph (e)(2) of this appendix G may be transmitted by overnight delivery. Notices filed pursuant to this paragraph will be accorded confidential treatment to the extent permitted by law; and

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(4) Upon the written request of the ultimate holding company, or upon its own motion, the Commission may grant an extension of time or an exemption from any of the requirements of this paragraph (e) either unconditionally or on specified terms and conditions as are necessary or appropriate in the public interest or for the protection of investors.

[69 FR 34467, June 21, 2004, as amended at 79 FR 1550, Jan. 8, 2014; 83 FR 50222, Oct. 4, 2018]

§ 240.15c3-2 [Reserved]

§ 240.15c3-3 Customer protection—reserves and custody of securities.

Except where otherwise noted, § 240.15c3-3 applies to a broker or dealer registered under section 15(b) of the Act (15 U.S.C. 78o(b)), including a broker or dealer also registered as a security-based swap dealer or major security-based swap participant under section 15F(b) of the Act (15 U.S.C. 78o-10(b)). A security-based swap dealer or major security-based swap participant registered under section 15F(b) of the Act that is not also registered as a broker or dealer under section 15(b) of the Act is subject to the requirements under § 240.18a-4.

(a) *Definitions.* For the purpose of this section:

(1) The term *customer* shall mean any person from whom or on whose behalf a broker or dealer has received or acquired or holds funds or securities for the account of that person. The term shall not include a broker or dealer, a municipal securities dealer, or a government securities broker or government securities dealer. The term shall, however, include another broker or dealer to the extent that broker or dealer maintains an omnibus account for the account of customers with the broker or dealer in compliance with Regulation T (12 CFR 220.1 through 220.12). The term shall not include a general partner or director or principal officer of the broker or dealer or any other person to the extent that person has a claim for property or funds which by contract, agreement or understanding, or by operation of law, is part of the capital of the broker or dealer or is subordinated to the claims of creditors of the broker or dealer. In